



Sept. 8, 2009

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: *Proxy Disclosure and Solicitation Enhancements File Number S7-13-09*

Dear Ms. Murphy:

I am writing to provide the Council of Institutional Investors' comments on the Commission's proposed rules on proxy disclosure and solicitation enhancements. The Council is a nonprofit association of public, corporate and labor pension funds representing more than \$3 trillion in assets. As a leading voice for long-term investors responsible for the retirement savings of millions of American workers and retirees, the Council welcomes the opportunity to share its views and recommendations on the proposed rules.

The need for timely, accurate and fulsome disclosures regarding corporate leadership, compensation and risk is more urgent than ever in view of the financial crisis and recession. Transparency promotes greater accountability and encourages the thoughtful, long-term approach to decision-making that corporate America desperately needs. Therefore, the Council applauds the Commission for taking a fresh look at current disclosure requirements and identifying and working to address gaps. We also appreciate the SEC's active solicitation of ideas for further transparency enhancements beyond the proposed rules. The Council's thoughts about the proposed rules and suggestions for additional disclosures follow. We believe that implementation of our recommendations will benefit all stakeholders in the U.S. capital markets.

#### **A. Enhanced Compensation Disclosure**

The Council strongly agrees that the Compensation Discussion and Analysis (CD&A) should contain a new section describing how the company's overall compensation policies for employees create incentives that could affect the company's risk profile and ability to manage that risk. We concur that the disclosure should cover all employees, since opportunities and incentives for engaging in unnecessary risk-taking can extend far beyond the C-suite. It is common wisdom that people generally do what you pay them to do. Therefore, investors need to know whether poorly-designed incentives are encouraging employees to make the potentially ruinous, excessively risky decisions that are at the heart of the financial crisis.

Also, we wholeheartedly agree that the Summary Compensation Table (SCT) and Director Compensation Table (DCT) disclosures of stock and option awards should use grant-date fair values, and not dollar amounts recognized for financial statement reporting purposes. When

it comes to offering insight into what a compensation committee intended to offer executives in a given year, the grant-date fair value is vastly superior to the FAS 123R accounting expense. Grant-date fair value reporting in the SCT and DCT is preferable, appropriate and consistent with pay disclosure's overall goal of giving shareowners the tools to assess the decisions of the compensation committee. We are glad the proposed rules align with our views on this matter, which we previously articulated in letters to the Commission dated Jan. 25, 2007, and March 29, 2006.

## **B. Enhanced Director and Nominee Disclosure**

The Council generally supports the proposed rules to expand the disclosure requirements regarding director and nominee qualifications, past directorships held by any directors and nominees and the period for disclosure of legal proceedings involving directors, nominees and executive officers.

One of the most fundamental duties of shareowners is to elect directors to serve on the boards of the companies in which they invest. Recent governance trends among large U.S. companies, such as electing directors by a majority of votes cast and declassifying boards, have made director elections more meaningful. Under the current disclosure regime, however, shareowners have scant information on which to base their vote.

Therefore, the Council strongly supports the proposed rules to require, for each incumbent director and nominee put forward by either the company or other proponents, disclosures about that individual's experience, qualifications and attributes or skills that qualify him or her to serve as a director and, if applicable, as a member of a particular board committee. To provide shareowners with meaningful information, the disclosures, for example, should identify an individual's specific skill set, such as manufacturing or public relations expertise, any relevant experiences or accomplishments in that area of expertise and how those skills would benefit the company. We believe that this more fulsome disclosure, on an annual basis, would help investors determine whether a particular individual and the board's composition overall are appropriate for the company.

The Commission requested comment on whether it should retain the disclosure currently required by Item 407(c)(2)(v).<sup>1</sup> We encourage the Commission to preserve this requirement as this information allows shareowners to gain an understanding of the overall quality of the board and the board's priorities. If disclosed in conjunction with individual director qualifications and skills as proposed, the information would significantly advance shareowners' ability to compare a nominee's background to the standards set by the board itself and to further evaluate board and committee composition.

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<sup>1</sup> Item 407(c)(2)(v) requires a company to: "Describe any specific minimum qualifications that the nominating committee believes must be met by a nominating committee-recommended nominee for a position on the registrant's board of directors, and describe any specific qualities or skills that the nominating committee believes are necessary for one or more of the registrant's directors to possess."

The Commission also requested comment on the whether shareowners would benefit from the disclosure of information relating to board diversity, committees and evaluations, in addition to the items currently proposed. More specifically, the Commission asked whether it should consider amending Item 407(c)(2)(v) to require disclosure of any additional factors, such as diversity, that a nominating committee may consider when selecting a director nominee.

The Council supports such disclosure. Board diversity is an issue of growing interest to Council members. Recent studies suggest there is a direct correlation between diversity and corporate financial performance.<sup>2</sup> Also, a diverse board better reflects the global reach of the modern corporation and could be a competitive advantage. On May 1, 2009, Council members approved an enhanced version of the Council's corporate governance policy on board diversity, to state:

The Council supports a diverse board. The Council believes a diverse board has benefits that can enhance corporate financial performance, particularly in today's global market place. Nominating committee charters, or equivalent, ought to reflect that boards should be diverse, including such considerations as background, experience, age, race, gender, ethnicity and culture.

In addition to disclosure relating to board diversity, the Council would welcome a rule extending the current disclosure requirements of audit, compensation and nominating/governance committees to all committees of the board. A board may form an additional standing committee to ensure that a significant issue, unique to the company or the industry, receives the necessary level of oversight. For example, boards of financial companies often establish a separate "risk" committee, and boards of oil companies often delegate safety or environmental risk to a dedicated committee.

If a matter is important enough to warrant a separate standing committee, shareowners likely will benefit greatly from a clear understanding of the committee's role in oversight. Extending the current disclosure requirements to include each committee of the board would help investors better understand the structure, function and quality of the board as a whole and at the committee level. Audit, compensation and nominating/governance committee disclosure requirements have improved committee members' accountability to shareowners. Applying the same standards to other board committees would serve shareowners well.

The Commission also requested comment on whether it would be helpful to shareowners if companies were required to disclose whether the board periodically evaluates its performance as a whole and the performance of board committees and individual directors. The Council urges boards to review their performance periodically and therefore would support a similar SEC rule. Information describing a company's process for evaluating the

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<sup>2</sup> The Bottom Line: Corporate Performance and Women's Representation on Boards (Catalyst, 2007) and Board Diversification Strategy: Realizing Competitive Advantage and Shareowner Value (Virtcom Consulting, 2009).

board, committees and individual directors would further help shareowners assess the qualifications and performance of directors.

The Council supports the Commission's proposal to require disclosure of any other public company directorships held by a director or nominee at any time during the past five years. We agree that the rule would allow investors to better evaluate the relevance of a director or nominee's past experience and the governance practices and performance of companies where that individual has served on the board. Moreover, expanding the disclosure requirement would shed light on any potential conflicts of interest associated with directors and nominees' prior board memberships.

The Council generally supports the Commission's proposal to extend the disclosure period for legal proceedings involving directors, director nominees and executive officers to 10 years. We believe that the additional disclosure would provide shareowners with valuable information for assessing the competence, character and overall suitability of a director, nominee or executive officer.

### **C. New Disclosure about Company Leadership Structure and the Board's Role in the Risk Management Process**

The Council strongly supports the proposed proxy disclosure requirements regarding corporate leadership structure, and believes that additional disclosures on other structural matters such as board size and independence would be useful to investors.

Council members regard board structure as a crucial component of corporate governance at all public companies, regardless of size. The Council has long advocated that boards should be chaired by an independent director and believes that the importance of independent board leadership warrants robust discussion in the proxy. The Council's policy on leadership structure states:

The board should be chaired by an independent director. The CEO and chair roles should only be combined in very limited circumstances; *in these situations, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director* who should have approval over information flow to the board, meeting agendas and meeting schedules to ensure a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors [emphasis added].

The Council also strongly supports the proposed required disclosures regarding the board's involvement in the oversight of risk management. As the financial crisis has highlighted, many boards failed in their responsibility to provide adequate oversight of risk management procedures and the overall level of corporate risk. Effective risk management is clearly fundamental for creating sustainable long-term shareowner value and thus warrants significant board involvement. Accordingly, we agree with the Commission that new

“disclosure about the board’s involvement in the risk management process should provide important information to investors about how a company perceives the role of its board and the relationship between the board and senior management in managing the material risk facing the company.”

For investors to adequately assess the board’s role in the oversight of risk management, proxy statement disclosures should include valuable information such as:

- How the board implements and conducts its risk management oversight function—through the board as a whole or through a committee, such as the audit committee, or multiple committees based on the type of risk
- Whether the individuals who oversee risk management report directly to the board as a whole, to a committee, such as the audit committee, or to one or more of the other standing committees of the board
- For each director who serves on a risk-related board committee or who has primary responsibility on the board for oversight of risk management, the experience, qualifications or skills that inform his or her ability to fulfill those duties
- The intervals at which risk management practices and oversight are reviewed, and whether such review is by the full board or its relevant committee or committees
- How risk management is structured at the company level, including the nature and rigor of its risk management program and procedures
- Whether the company utilizes a chief risk officer or risk management group
- How the nature and type of the company’s risk exposures influence how the board and management conduct risk review and oversight
- Whether executives responsible for risk management have independent access to the board or its designated committee or committees that oversee risk

#### **D. New Disclosure Regarding Compensation Consultants**

The Council applauds the Commission’s proposal requiring disclosure of the nature and dollar amount of services provided to management by the compensation committee’s consultant. The mandatory disclosure of this information will help expose perceived or actual consulting-related conflicts of interest. More sunlight should lead to greater accountability and better, fairer pay advice. Ultimately, this will promote more efficient and effective use of investor dollars to incentivize superior, sustainable, long-term shareowner value creation.

#### **E. Reporting of Voting Results on Form 8-K**

The Council strongly supports the proposed rule on reporting of voting results. As written, the proposal falls largely in line with the Council’s own policy on the subject.

The ability to cast a vote at annual and special meetings is a fundamental right of shareowners. It ensures that voices of shareowners both large and small are heard. Timely

disclosure of voting results is critical to effective communication between shareowners, the board and management.

Current SEC requirements, however, allow companies to delay the disclosure of the results of director elections and other ballot items for more than four months after the vote. That only serves to widen the communication gap between boards and shareowners and effectively diminishes the voice of investors. The lengthy delay allows boards to sideline the process of engaging shareowners on shareowner proposals that received high levels of support. Most seriously, such a delay can stall director transitions, allowing a director unseated at an annual meeting to extend his or her influence over the direction of the company.

Earlier release of final tallies would cultivate an environment of open communication and board accountability to shareowners. Timely acknowledgment of shareowners' positions on important governance matters could also result in more efficient use of company and shareowner resources on resolutions that garnered substantial levels of support.

Technological advances let companies obtain final voting results far more quickly and efficiently than ever before. We recognize that complications may arise in certain circumstances and believe that the amendment as written would provide companies the appropriate amount of leeway.

## **H. Other Requests for Comment**

### Equity Awards' Issue Dates and Performance Periods

The Council believes companies should be required to include a footnote to equity awards included in the SCT that would disclose the award's issue date and performance period (e.g., "issued on Feb. 15, 2008, for fiscal 2005-2007 performance"). Currently, the proxy statement shows equity award issue dates but not performance periods. We also feel that the Form 4 disclosures which companies file within four days of issuing equity awards should explain the reason for the award (e.g., "This award was granted by the compensation committee under the Long Term Incentive Plan because the executive posted X performance on Y metric during the 2005-2007 plan performance cycle"). These changes will make it easier to match a given period's pay with that period's performance in a timely manner and thereby allow shareowners to readily evaluate the rigor and alignment of incentive plans.

### Internal Pay Equity

A wide pay chasm between the CEO and those just below can indicate key person risk, poor succession planning and a weak compensation committee, and can demoralize and demotivate senior managers. Therefore, companies should disclose and provide meaningful analysis of internal pay equity, taking into consideration various executive compensation levels and average compensation levels for rank-and-file employees. To allow investors to evaluate compensation committee vigilance and performance, companies should disclose any steps that the compensation committee considered or took to reduce worryingly-large pay gaps.

### Incentive Plan Performance Targets

The Council strongly encourages the Commission to require companies to provide post-award disclosure of pay plan performance targets. The “competitive harm” exemption for this sort of disclosure should be eliminated. Far too many companies appear to be withholding disclosure of the actual goals on which they base incentive rewards with questionable justification. Disclosure of performance targets enables shareowners to evaluate the design of incentive programs as well as the fit between the objectives used to motivate executives and the company’s business goals. The Council’s own compensation disclosure policy states that:

The compensation committee should commit to provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine compensation, including the weightings of each measure. At the beginning of a period, the compensation committee should calculate and disclose the maximum compensation payable if all performance-related targets are met. *At the end of the performance cycle, the compensation committee should disclose actual targets and details on final payouts. Companies should provide forward-looking disclosure of performance targets whenever possible [emphasis added].*

### Compensation Committee Knowledge, Expertise and Resources

The Council also respectfully requests that the Commission require proxy disclosures discussing the relevant knowledge and expertise of each member of the compensation committee – to the extent that is not covered under the “Enhanced Director and Nominee Disclosure” proposal – and the resources available to the committee to hire external consultants and legal advisers. Successful board oversight of executive compensation requires that members of the compensation committee be or take responsibility to become knowledgeable about compensation and related issues. In a related vein, the Council also believes that compensation committees should be able to retain and fire outside experts, including consultants, legal advisers and any other advisers they deem appropriate.

### Stock Ownership and Holding Policies

Disclosures regarding key features of executive compensation designed to align management with long-term shareowners would be particularly valuable for investors. The financial crisis has made painfully clear the destructive impact of perverse compensation practices that reward short-term performance at the expense of long-term value. Sound compensation encourages the pursuit of sustainable returns and discourages excessive risk taking.

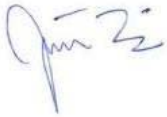
In that vein, the Council believes that disclosure about company stock ownership requirements would be especially valuable. The disclosures should discuss both the scope and the duration of ownership requirements – how much equity executives and directors are required to hold and for how long.

Clawback Policies

Also critical are details about the company's clawback policy for reviewing unearned bonus and incentive payments that were awarded to executive officers. Required disclosures should discuss the circumstances that would trigger the board's review, recovery or cancellation of bonus or incentive payments.

Thank you for the opportunity to comment on the proposed rules. If you have any questions, please contact me at 202-261-7088 or [justin@cii.org](mailto:justin@cii.org).

Sincerely,

A handwritten signature in blue ink, appearing to read "Justin Levis".

Justin Levis  
Senior Research Associate