



April 28, 2010

The Honorable Harry Reid
Senate Majority Leader
S-221 The Capitol
Washington, DC 20510-7020

The Honorable Mitch McConnell
Senate Minority Leader
S-230 The Capitol
Washington, DC 20510-7010

Dear Majority Leader Reid and Minority Leader McConnell:

As financial regulatory reform legislation advances in the Senate, I am writing on behalf of the Council of Institutional Investors (“Council”) in strong support of the corporate governance provisions included in the *Restoring American Financial Stability Act of 2010* (S. 3217).¹

A nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion, the Council represents major, long-term investors with a duty to protect the retirement savings of millions of American workers across the country. Significantly affected by the financial crisis, Council member funds have a deep interest in meaningful financial regulatory reform. We accordingly support the Senate’s comprehensive efforts to strengthen the regulation of the United States (“U.S.”) financial system.

The global financial crisis represents a massive failure of board oversight as well as government regulation. Clearly directors failed to adequately understand and monitor enterprise risk and corporate strategy. Council member funds and as a result American workers and retirees have paid a steep price for these failures. Not only have they suffered billions of dollars in investment losses, they have also lost confidence in the integrity of our markets and in the effectiveness of board oversight of corporate management. Nevertheless, as Warren Buffett observed in his most recent letter to Berkshire Hathaway shareowners, “directors of the failed companies...have largely gone unscathed.”²

Few meaningful remedies are currently available to shareowners dissatisfied with management and board performance at U.S. public companies. The Council accordingly shares President Barack Obama’s view that important reforms are needed to “give shareholders new power in the financial system...so that investors and pension holders have a stronger role in determining who manages the companies in which they’ve placed their savings.”³

The U.S. has long been recognized as a leader when it comes to investor protection and market transparency. But America has seriously fallen short when it comes to corporate governance. Today shareowners around the world—including in countries with far less developed capital markets than ours—enjoy basic rights that shareowners of American companies are denied. Rights such as requiring directors to be elected by majority vote and providing long-term owners a modest vehicle to nominate directors on company proxy cards are all noticeably absent in much of corporate America. Their absence significantly weakens the ability of shareowners to oversee corporate directors—their elected representatives—and hold them accountable.

¹ Restoring American Financial Stability Act of 2010, S. 3217, 111th Cong.

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s3217pcs.txt.pdf.

² Letter from Warren E. Buffett, Chairman of the Board, to the Shareholders of Berkshire Hathaway Inc., 16 (Feb. 26, 2010), www.berkshirehathaway.com/letters/2009ltr.pdf.

³ President Barack Obama. “Remarks by the President on Wall Street Reform.” Cooper Union, New York, NY. 22 Apr. 2010. White House Office of the Press Secretary.

www.whitehouse.gov/the-press-office/remarks-president-wall-street-reform.

Restoring American Financial Stability

The role of inadequate corporate governance in the financial meltdown is well recognized.⁴ As the *Economist* recently noted, “Directors’ lack of engagement or expertise played a big part in some of the worst slip-ups.”⁵ The Council thus believes that governance enhancements such as those included in the *Restoring American Financial Stability Act* are an essential component of the bold reforms required to restore financial stability and confidence in U.S. capital markets. By empowering long-term investors to hold corporate directors accountable, provisions regarding proxy access and majority voting would help address the failures of board oversight that contributed to the financial crisis, reducing the risk that such a crisis ever happens again.

Proxy Access. Section 972 of the Act affirms the Securities and Exchange Commission’s (SEC) authority to issue a uniform proxy access rule, finally giving substance to investors’ right under state law to nominate directors. Currently, the only way shareowners can present alternative director candidates at a U.S. public company is by waging a full-blown election contest. For most investors this is onerous and prohibitively expensive. As a result, incumbent directors hold a monopoly on the corporate ballot that effectively renders shareowners’ right to nominate meaningless. A measured right for significant long-term investors to place their board nominees on the company’s proxy card, as proposed by the SEC, would overcome these obstacles, invigorating board elections and making directors more responsive, thoughtful, and vigilant.⁶

While the Council is confident that the Commission already has the authority to issue a uniform proxy access rule, others disagree. The SEC is thus likely to face unnecessary, costly and time-consuming litigation upon finalizing an access rule. Such litigation would benefit a handful of lawyers and many poorly performing corporate directors to the detriment of investors. If enacted, Section 972 would ensure that owners of U.S. companies face no needless delays in the implementation of this long-overdue and essential corporate governance reform.

Majority Voting. Section 971 of the Act establishes majority voting for directors in uncontested elections. Under most state laws, including Delaware, the default standard for such elections remains a plurality vote. A director can thus be elected even if a majority of the votes are withheld from the nominee. By denying shareowners a meaningful vote for corporate directors, plurality voting in uncontested elections is inherently unfair and undemocratic. Majority voting, on the other hand, makes directors more accountable to shareowners by giving their votes meaning and eliminating the current “rubber stamp” process.⁷

Simply making boards more representative of shareowners, majority voting democratizes the corporate electoral process, puts real voting power in hands of investors, and results in minimal disruption to corporate affairs. Given the failure by the states, particularly Delaware, to take the lead on this reform, the time has come for the U.S. Congress to guarantee this important and very basic shareowner right.

⁴ Grant Kirkpatrick, Organization for Economic Cooperation and Development (OECD), *The Corporate Governance Lessons from the Financial Crisis*, 2 (Feb. 2009), www.oecd.org/dataoecd/32/1/42229620.pdf. (“The financial crisis can be to an important extent attributed to failures and weaknesses in corporate governance arrangements.”)

⁵ “Special Report on Financial Risk: Cinderella’s Moment.” *Economist* 11 Feb. 2010. www.economist.com/specialreports/displaystory.cfm?story_id=15474145.

⁶ Facilitating Shareholder Director Nominations, 74 Fed. Reg. 29024 (June 18, 2009), www.sec.gov/rules/proposed/2009/33-9046fr.pdf.

⁷ The Council membership recently revised our majority voting policy to require boards to accept the resignation of a director that fails to receive majority support in all but very limited circumstances. For the full text of the Council’s corporate governance policies please visit www.cii.org/policies.

Strengthening American Companies

As part of a broad financial regulatory overhaul, corporate governance reform in the long run will help foster genuine market discipline leading to more prosperous companies, more stable jobs, and a more secure retirement for American workers. The financial benefits of greater board oversight are well documented. According to Professor Lucian Bebchuk of Harvard Law School, “There is a substantial body of empirical evidence that is consistent with the view that making boards more accountable by invigorating corporate elections increases shareholder value.”⁸ Professor Bebchuk also reports that there is considerable evidence that “reducing incumbent directors’ insulation from removal” leads to better corporate management, and that increased insulation conversely leads to poor performance.⁹

As owners of the Nation’s largest and most prominent corporations, Council members are strongly aligned with corporate America—we have every interest in its long-term success and profitability. The Council believes that market discipline and accountability are hallmarks of a vibrant and healthy capitalist system. These values must begin in the boardroom with strong corporate governance. Far from a harmful government mandated “one size fits all” approach, the governance reforms included in the *Restoring American Financial Stability Act* are designed to guarantee the fundamental rights shareowners need to act as responsible owners.

Lessons of the Financial Crisis

Together, proxy access and majority voting would go a long way toward more meaningful oversight by public companies’ owners—their investors. While more vigorous government regulation is surely needed, corporate boards are the first line of defense against the risks and excesses that led to the global financial crisis. As the blue-ribbon Investors’ Working Group concluded, “Vigorous regulation alone cannot address all of the abuses that paved the way to financial disaster. Shareowner-driven market discipline is also critical.”¹⁰ Regulators and *investors* must accordingly be given stronger market-based tools necessary to guarantee robust oversight and meaningful accountability of corporate managers and directors.

Thank you for consideration of the views of investors and for your leadership on financial regulatory reform. We look forward to continuing to work with you to strengthen corporate governance and the entire U.S. financial system. If you have any questions, please feel free to contact me at (202) 261-7081 or jeff@cii.org.

Sincerely,



Jeff Mahoney
General Counsel
Council of Institutional Investors

Cc: Members of the United States Senate

⁸ Lucian A. Bebchuk and Scott Hirst, *Private Ordering and the Proxy Access Debate*, *The Business Lawyer*, 8 (Feb. 2010) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1513408).

⁹ *Id.*

¹⁰ Investors Working Group, *U.S. Financial Regulatory Reform: The Investors’ Perspective* (July 2009), at 22, www.cii.org/UserFiles/file/IWGreport.pdf. For more information, please visit www.cii.org/iwgInfo.