



November 25, 2009

Ms. Jennifer J. Johnson  
Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue, NW  
Washington, DC 20551

Re: Proposed Guidance on Sound Incentive Compensation Policies  
(Docket No. OP-1374)

Dear Ms. Johnson:

I am writing on behalf of the Council of Institutional Investors (Council) to discuss the Federal Reserve System's proposed guidance on sound incentive compensation policies. 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 thoughts on the proposal.

The Council applauds the guidance, which furthers the Federal Reserve's goal of preventing banks' incentive compensation policies from undermining the safety and soundness of their organizations and the capital markets at large. We agree with Federal Reserve Chairman Ben Bernanke that pay practices at some banks led to misaligned incentives and excessive risk-taking, contributing to bank losses and financial instability in the global economy.

Therefore, it is appropriate and necessary for the Federal Reserve to ensure compensation packages appropriately tie rewards to longer-term performance and do not create undue risk for the firm or the financial system. To this end, the Council has additional recommendations to help banks promote long-run, sustainable shareowner value creation instead of destructive myopia.

#### **Disclosure of Performance Goals**

The compensation committee should provide full disclosure of the performance goals used to determine annual and long-term incentive pay. Such disclosure would provide the marketplace the information necessary to evaluate whether the compensation programs encourage excessive risk-taking.

#### **Diversity of Performance Metrics**

We also advocate diverse performance metrics that are not duplicated in the short-term and long-term pay plans. Multiple definitions of success increase plan safety by discouraging executives from boosting one metric while ignoring others.

#### **Stock Ownership**

The compensation committee should ensure executives own, after a reasonable period of time, a meaningful position in the company's common stock. This should curb excessive risk-taking by encouraging executives to act in ways that create sustainable shareowner value over the long term.

**Severance Pay**

The Council believes that severance pay awarded to an executive who leaves a company as a result of poor performance amounts to “pay for failure.” Such payments promote excessive risk-taking by insulating managers from the negative personal financial consequences of their actions. Therefore, we recommend that no severance be paid at all in the event of termination for poor performance, resignation under pressure or failure to renew an employment contract.

**Stock Option Repricing**

Option repricings for executives should also be avoided, since they shield managers from downside risk.

**Advisory Shareowner Vote on Executive Pay**

All companies should provide shareowners an annual, advisory vote on the compensation of senior executives. Such a mechanism would efficiently and effectively provide boards with useful information about whether investors view the company’s compensation practices to be in shareowners’ best interests. The possibility of a high “against” vote might serve as an additional deterrent against incentive plans that promote excessive and unnecessary risk-taking.

Ultimately, many directors will not adhere to best pay practices, such as those listed above, unless they fear for their board seats. That is why two broader corporate governance reforms are imperative:

**Majority Voting for Directors**

All public companies should require directors in uncontested situations to be elected by a majority of votes cast. Shareowners need the ability to vote head-in-the-sand directors off of boards. They can’t do that at the many U.S. companies where directors are elected through plurality voting, which rigs elections in favor of incumbents.

**Proxy Access**

Investors also need a way to get more responsive and responsible directors onto boards. For that to happen, the Federal Reserve should throw its support behind the Securities and Exchange Commission’s initiative to give owners access to the proxy to nominate directors. Proxy access will make it easier for investors to nominate their own director candidates.

In addition, we support the Federal Reserve’s supervisory initiatives to make sure banking organizations are implementing the guidance, and we look forward to the forthcoming report on developments and trends in banks’ pay practices.

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

Sincerely,



Justin Levis  
Senior Research Associate