

COUNCIL OF INSTITUTIONAL INVESTORS

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November 20, 2008

The Honorable Neel Kashkari
Interim Assistant Secretary for Financial Stability
U.S. Department of the Treasury
Office of Financial Institutions Policy
Room 1418
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: *Executive compensation provisions of the Troubled Assets Relief Program's (TARP) Capital Purchase Program (CPP)*

Dear Assistant Secretary Kashkari:

I am writing on behalf of the Council of Institutional Investors, a not-for-profit association of more than 140 public, corporate and union pension funds with combined assets exceeding \$3 trillion. The Council appreciates the opportunity to comment on the executive compensation provisions of the interim CPP rule. Please note that the policy recommendations contained in this letter are relevant to any firm receiving government assistance under the various programs of the Emergency Economic Stabilization Act of 2008 (EESA), and to all companies generally.

The Council fully agrees that the executive compensation of companies accepting government assistance through the EESA should be subject to limitations, since poorly structured pay programs and practices can encourage the get-rich-quick mentality and overly risky behavior that caused this financial crisis. By recognizing that pay motivates behavior, the interim CPP rule goes a long way towards fostering a compensation environment conducive to the creation of superior, sustainable, long-term shareowner value, which is in the best interests of companies, boards, executives, shareowners, Treasury and taxpayers.

However, the Council has several recommendations for making the rule even more beneficial to stakeholders. These recommendations are based on the Council's corporate governance policies and represent best executive pay practices applicable to *all* companies, but especially companies receiving government assistance. Therefore, we respectfully urge Treasury to incorporate our suggestions into the final rule, and thereby set a meaningful, reasonable and common-sense gold standard for pay transparency, accountability, effectiveness and rigor. This standard should be imposed on government-

assisted firms and voluntarily adopted by all companies interested in eliminating excessive risk-taking and incentivizing and rewarding sound decision-making that results in the generation of long-run shareowner wealth.

Compensation Committee Requirements. The Council has many executive pay policies relevant to Treasury’s goal of discouraging excessive and unnecessary risk-taking. Several of these Council guidelines are included below as core reforms we believe should be incorporated in the final rule for the benefit of all CPP stakeholders.ⁱ In any case, robust Treasury oversight and enforcement is necessary to ensure risk is properly managed.


- The compensation committee should provide full *disclosure of the performance goals* used to determine annual and long-term incentive compensation. Such disclosure would provide the marketplace the information necessary to evaluate whether the compensation programs encourage excessive risk-taking.
- The compensation committee should set incentive plan *performance levels above which bonuses would be capped*, since an unlimited potential upside promotes excessive risk-taking. These caps should not be calculated as percentages of accounting or other financial measures (such as revenue, operating income or net profit), since these figures may change dramatically due to mergers, acquisitions and other non-performance-related strategic or accounting decisions. Caps based on accounting or other financial measures could encourage executives to make short-sighted decisions that pump up the numbers and lift their incentive pay but ultimately negatively impact long-term shareowner returns.
- The compensation committee should ensure executives own, after a reasonable period of time, a *meaningful position in the company’s common stock, and hold a significant portion of their equity-based compensation*ⁱⁱ for a period beyond their tenure. These measures should curb excessive risk-taking by encouraging executives to act in ways that create sustainable shareowner value over the long term. The Council believes a meaningful proportion of executive pay should be in an equity-based form.
- For CPP participants that are public companies, the compensation committee 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 majority “against” vote might serve as an additional deterrent against devising incentive plans that promote excessive and unnecessary risk-taking.

Clawback Provisions. Since opportunities for excessive risk-taking extend far beyond financial institutions’ top five officers, we recommend that the CPP clawback provisions apply *to all senior executives*, not just to the CEO, CFO and the three other most highly paid executives.

Golden Parachutes. The Council believes severance pay awarded to executives that leave a company as a result of poor performance amounts to “pay for failure.” 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.

Thank you for your work to date in this area and for considering our comments. For your further reference and information, a copy of the Council’s full executive pay policies is attached. Please feel free to contact me with any questions.

Sincerely,



Justin Levis
Senior Research Associate

Attachment

ⁱ We recognize that CPP participants may not necessarily be publicly traded companies, and therefore may not be accustomed to publicly disclosing compensation information and policies. However, since all participating institutions will take public money through the program, we feel that all CPP participants should make the beneficial and warranted public disclosures recommended in this letter.

ⁱⁱ The importance of holding equity compensation post-termination is echoed in the Aspen Institute’s guiding principles for corporations and investors on long-term value creation, which are available online at <http://www.aspeninstitute.org/atf/cf/%7BDEB6F227-659B-4EC8-8F84-8DF23CA704F5%7D/FinalPrinciples.pdf>. The Aspen Principles were endorsed by the Council, several major U.S. corporations, the Business Roundtable, Financial Executives International and the U.S. Chamber of Commerce, among others.