



Via Facsimile

November 18, 2009

The Honorable Christopher J. Dodd, Chairman
Senate Committee on Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

I am writing on behalf of the Council of Institutional Investors, a nonprofit association of public, union and corporate pension funds with combined assets that exceed \$3 trillion. Member funds are major shareowners with a duty to protect the retirement assets of millions of American workers.

As a leading voice for long-term, patient capital, the Council supports your comprehensive efforts to reform the regulation of the U.S. financial system. We are pleased to see that many key provisions of the *Restoring American Financial Stability Act of 2009* discussion draft align with the Council's regulatory reform priorities.¹ In particular, the Council is most encouraged that your proposed legislation includes reforms designed to strengthen corporate governance, enhance the oversight and accountability of credit rating agencies, establish meaningful regulation of over-the-counter (OTC) derivatives, and bolster the resources and independence of the Securities and Exchange Commission (SEC).²

Strengthen Corporate Governance

The global financial crisis represents a massive failure of oversight. In order to restore trust and ensure that such a crisis never happens again, regulators and investors must be given the tools necessary to guarantee robust oversight and meaningful accountability of corporate managers and directors. Investors in particular need stronger market-based tools to hold managers and boards accountable. The key corporate governance improvements included in your discussion draft would go a long way toward more meaningful oversight by public companies' owners—their investors. Such measures would address, at least in part, many of the problems that led to the current crisis. More importantly, they would empower shareowners to anticipate and potentially address future risks. Many of the corporate governance enhancements included in the *Restoring American Financial Stability Act* are supported by both longstanding Council policy and the recent recommendations of the Investors Working Group (IWG).³

¹ For an overview of the Council's corporate governance reform priorities, please see our December 2008 letter to Congress signed by representatives of over 40 member funds, available online at <http://www.cii.org/UserFiles/file/resource%20center/correspondence/2008/CII%20Corporate%20Governance%20Reform%20Advocacy%20Letter.pdf>.

² For information about the Council's views on reform in areas beyond corporate governance, please see the Investors' Working Group (IWG) July 2009 report, *U.S. Financial Regulatory Reform: The Investors' Perspective*, available online at <http://www.cii.org/iwglInfo>.

³ For more information on the Council's Corporate Governance Policies and other official policy statements such as our statement on the Transparency, Independence and Oversight of Financial Gatekeepers, please visit <http://www.cii.org/policies>.

- *Shareowner Access to the Proxy.* The only way that shareowners can present alternative director candidates at a U.S. public company is by waging a full-blown election contest. For most investors, that is onerous and prohibitively expensive. A measured right for investors to place their nominees for directors on the company's proxy card would overcome these obstacles, invigorating board elections and making directors more responsive, thoughtful and vigilant. By reaffirming the SEC's authority to issue a proxy access rule, the *Restoring American Financial Stability Act* assists the commission's efforts to issue and implement a uniform proxy access rule without unnecessary and costly delays.
- *Majority Voting for Directors.* At most U.S. public companies, directors are elected by a plurality of votes cast, rather than by a majority. Since nearly all director elections are uncontested, plurality voting results in "rubber stamp" elections and directors who are accordingly less accountable to shareowners. As mandated by the discussion draft, majority voting in uncontested elections ensures that shareowners' votes count and makes directors more accountable to the company's owners.
- *Advisory Shareowner Vote on Executive Compensation.* Perverse executive pay incentives encouraged excessively risky behavior by financial firms that contributed to the current financial crisis. An advisory shareowner vote on executive compensation and golden parachutes as provided in the discussion draft would induce compensation committees to be more careful about doling out rich rewards and provide boards with useful information about whether investors view the company's compensation practices to be in shareowners' best interests.
- *Compensation Committee Independence.* Compensation committees and their external consultants play a key role in the pay-setting process. Conflicts of interest contribute to a ratcheting up effect for executive pay, however, and should thus be minimized and disclosed. Reforms included in the discussion draft would help ensure that compensation committees are free of conflicts and receive unbiased advice.
- *Clawbacks.* It is in the best economic interests of shareowners for boards to recoup incentive awards erroneously paid to executives. The strong clawback policies required by your comprehensive reform legislation would effectively discourage executives from taking questionable actions that temporarily lift share prices but ultimately result in financial restatements.
- *Disclosure of Board Leadership Structure.* Council member funds regard board leadership structure as a crucial component of corporate governance. Strong CEOs can exert a dominant influence on the board and its agenda and thus weaken the board's oversight of management. Since the Council has long advocated that boards should generally be chaired by an independent director, we strongly support provisions of the discussion draft requiring companies to disclose the reasons behind their particular board leadership structure so that investors can accurately assess the rigor of a company's governance.

Enhance Oversight and Accountability of Credit Rating Agencies

Credit rating agencies are financial “gatekeepers” to the capital markets. Their ratings enable companies to sell debt and give investors critical information they need to make informed investment decisions. Despite their semi-official status, rating agencies that are NRSROs (Nationally Recognized Statistical Rating Organizations) historically have faced minimal regulation. Accordingly, it is not surprising that rating agencies were at the heart of the global financial crisis. Wildly inflated ratings of structured financial products helped to fuel the financial meltdown. The Council supports your efforts to restore the credibility of credit rating agencies as trusted financial gatekeepers. In line with both the Council’s policy statement on the Transparency, Independence and Oversight of Financial Gatekeepers as well as the recommendations of the IWG, we support the discussion draft reforms designed to enhance SEC oversight of credit rating agencies, strengthen their governance and internal controls, improve the transparency of rating methodologies and assumptions and make rating agencies truly accountable to the investors that depend on them.

Establish Meaningful Oversight of OTC Derivatives

Unregulated trading in OTC derivatives contracts, especially credit default swaps, was at the heart of the global financial crisis. The global OTC derivatives market is enormous, yet virtually exempt from all regulation under the Commodity Futures Modernization Act of 2000. Prices are hidden, speculation is rampant and leverage is high. Although derivative contracts can help manage risk, left unchecked, they can also multiply and spread risk throughout the financial system, increasing the possibility of enormous damage. The Council supports your efforts in the discussion draft to bring meaningful regulation and transparency to this highly influential market. Like the Investors’ Working Group, we believe that the best way to ensure effective government oversight and a stable trading environment is to require all standardized and standardizable OTC derivative contracts to trade on regulated exchanges and clear centrally. Exchange trading provides the transparency that investors such as Council member funds need to comparison-shop and ultimately pay lower transaction fees—leaving more for pension fund beneficiaries.

Bolster the Resources and Independence of the SEC

Above all, financial regulators must be committed to promoting policies that are good for consumers, investors and the U.S. capital markets. The financial crisis has demonstrated, however, that regulators lacked the knowledge and resources needed to flexibly respond to rapid financial innovation and market expansion. Poor funding and a lack of independence clearly helped to undermine vigorous regulatory oversight. The ups and downs of the Congressional appropriations process have served to especially undermine the regulatory mission of the Securities and Exchange Commission. The Council therefore strongly supports the provisions of the *Restoring American Financial Stability Act* that would provide self-funding for the SEC. The SEC, unlike most other federal financial regulators that are self-funded, has been buffeted repeatedly by changes in the political winds. Self-funding is critical so the SEC can plan for the long term and be better able to respond to future unknown risks. Self-funding would further ensure that the commission has a workforce of sufficient size and skill to oversee the nation’s securities markets, including potential expansions into areas such as OTC derivatives and private fund advisers.

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The Council of Institutional Investors appreciates your strong leadership in the effort to comprehensively reform and strengthen the regulation of the U.S. financial system. We are encouraged that many institutional investor reform priorities are reflected in the *Restoring American Financial Stability Act of 2009* discussion draft. The Council looks forward to continuing to work with you, Ranking Member Shelby, and other members of the Committee to ensure that the views of investors continue to be part of the regulatory reform debate as the legislative process moves forward. If you have any questions about the Council's views on financial regulatory reform, particularly in the areas discussed above, please do not hesitate to contact me at (202) 261-7081, or jeff@cii.org, or Council analyst Jonathan Urick at (202) 261-7096 or jonathan@cii.org.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeff Mahoney
General Counsel
Council of Institutional Investors

CC: The Honorable Richard C. Shelby, Ranking Member, Committee on Banking, Housing,
and Urban Affairs