

# COUNCIL OF INSTITUTIONAL INVESTORS

Via Hand Delivery

April 5, 2007

The Honorable Barney Frank  
House of Representatives  
Washington, DC 20515

Dear Mr. Chairman:

On behalf of the members, board of directors, and staff of the Council of Institutional Investors (“Council”), I am writing to congratulate you on the Committee on Financial Services (“Committee”) successful mark-up of H.R. 1257, the “Shareholder Vote on Executive Compensation Act.”

The Council is an association of more than 135 corporate, public and union pension funds with more than \$3 trillion in pension assets. Council members are responsible for investing and safeguarding assets used to fund pension benefits of millions of participants and beneficiaries throughout the United States (“US”). Since the average member invests approximately 75 percent of its entire pension portfolio in US stocks and bonds, issues relating to US corporate governance and the Committee’s critical oversight role with respect to those issues are of great interest to our members.

The Council believes that executive compensation is a critical and visible aspect of a company’s governance. Pay decisions are one of the most direct ways for shareowners to assess the performance of the board.

On March 20, 2007, the Council’s general members unanimously approved the following revision to the Council’s corporate governance policies:

Companies should provide annually for advisory  
shareowner votes on the compensation of senior executives.

In approving this policy, Council members generally agreed that an annual shareowner vote on executive compensation would benefit investors and the capital markets for a number of reasons.

Provides a mechanism for ongoing input on compensation

First, while investors have grown more concerned about perceived excesses and abuses of executive pay at US public companies, they have limited ability to signal their disapproval to boards or to shape pay policies. A December 2006 study by *The Corporate Library* found that the median total compensation for some 1,700 chief executive officers (“CEO”) nearly tripled from fiscal 1999 to 2005. Ninety percent of institutional investors think US executives are overpaid, according to a 2005 *Watson Wyatt* survey of 55 institutions managing a total of \$800 billion in assets.

While non-binding votes on executive pay practices are required in Australia, Sweden and the United Kingdom (“UK”), shareowners of US companies currently have no way to directly vote on all compensation matters. US stock exchanges mandate shareowner approval of equity-based compensation plans and investors must endorse performance criteria before companies can deduct compensation exceeding \$1 million, but compensation committees have substantial leeway in setting yearly performance targets and granting awards. Investors at US companies currently do not have a mechanism to provide ongoing input on how a company’s general compensation policies are applied to individual pay packages.

Provides a less blunt instrument than withholding support from directors

Second, shareowners can and do withhold support from compensation committee members standing for re-election, but withhold campaigns can be a blunt instrument for registering dissatisfaction with the committee’s administration of pay plans and policies. The tactic can threaten the position of directors “who may very well have argued against the issue which causes shareholder concern, and often puts management in the position of having to defend individual directors,” says Bess Joffe, manager for the Americas at *Hermes Equity Ownership Services*. She added, “[t]hese situations tend to escalate and become quite personal, ultimately distracting from the issue at hand.”

Non-binding shareowner votes on executive pay might deter votes against directors since shareowners would have a “more specific and accurate place on the proxy to communicate concerns over pay,” says Elizabeth McGeeveran, vice president for governance and socially responsible investment at *F&C Asset Management* (“F&C”). Of course, if a compensation committee failed to respond to an advisory vote that showed significant shareowner disapproval of pay practices, “investors might vote against committee members the following year,” says Daniel Summerfield, investment adviser to the *Universities Superannuation Scheme*, one of the UK’s largest pension funds.

Positive results in the UK

Finally, UK regulations requiring advisory shareowner votes on executive compensation went into effect in 2002, and have resulted in “better disclosure, better and more dialogue between shareholders and companies, and more thought put into remuneration policy by directors,” according to David Paterson, research director of UK-based *Research, Recommendations and Electronic Voting*, a proxy advisory service. British drugmaker *GlaxoSmithKline* (“GSK”) is a case-in-point. In 2003, 51 percent of GSK shareowners protested the CEO’s golden parachute package by either voting against or abstaining from voting on the company’s remuneration report. Stunned, the GSK board held talks with shareowners and the next year reduced the length of executive contracts and set new performance targets, muting investor criticism. Other UK companies got the message and now routinely seek investor input on compensation policies.

There is no guarantee that all the benefits attained from advisory shareowner votes on executive pay in the UK would be realized in the US. Stock ownership is far more concentrated in the UK, and British institutional investors have a strong tradition of standing up to company management and boards. As a result, UK boards are more inclined to take investor concerns about pay seriously. Even so, advisory shareowner votes—by their very nature—would benefit investors in US companies by providing a clear and direct way to communicate their views on executive compensation. “Voting results could also give directors leverage to resist executives’ demands for lavish rewards,” adds McGeveran of F&C.

In summary, the Council believes that an annual shareowner advisory vote on executive compensation would efficiently and effectively provide boards with useful information about whether investors view the company’s compensation practices to be in shareowners’ best interests. Nonbinding shareowner votes on pay would serve as a direct referendum on the decisions of the compensation committee, and would offer a more targeted way to signal shareowner discontent than withholding votes from committee members.

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Thank you again for your leadership and efforts to improve corporate governance practices. We look forward to continuing to work closely with you and your staff to ensure that the US capital market system continues to serve the needs of investors.

Sincerely,

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

Jeff Mahoney  
General Counsel

cc: The Honorable Spencer Bachus, Ranking Member, Committee on Financial Services  
The Honorable Paul E. Kanjorski, Chairman, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises  
The Honorable Deborah D. Pryce, Ranking Member, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises  
The Honorable Christopher J. Dodd, Chairman, Committee on Banking, Housing, and Urban Affairs  
The Honorable Richard C. Shelby, Ranking Member, Committee on Banking, Housing, and Urban Affairs  
The Honorable Jack Reed, Chairman, Subcommittee on Securities, Insurance, and Investment  
The Honorable Wayne Allard, Ranking Member, Subcommittee on Securities, Insurance, and Investment