

COUNCIL OF INSTITUTIONAL INVESTORS

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September 27, 2007

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

RE: Compensation disclosure compliance review process; Shareowner perspective on improving the Compensation Discussion and Analysis (CD&A)

Dear Chairman Cox:

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 commends the Securities and Exchange Commission for the recent actions it has taken as part of a larger review of companies' compliance with the new executive compensation disclosure rules. This initiative is an important step toward addressing the discernible lack of quality reporting in the Compensation Discussion and Analysis (CD&A) disclosures over the last proxy season. As the Commission moves forward with better reporting initiatives, the Council urges it to focus on the critical reporting items detailed below and to address such items in any future rulemaking.

Improving the quality of executive compensation disclosure has long been a top priority of the Council and its members. Council policy recommends that executive compensation programs tie pay tightly to company performance, promote sustainable long-term value creation and be structured in accordance with a company's strategic goals. Evaluating board-level compensation decisions requires that shareowners have complete and thorough information about compensation programs, the compensation committee's pay-setting process and the relationship between compensation decisions and the company's business objectives.

It is therefore critical that the new Compensation Discussion & Analysis section of the proxy statement fulfill the expectations of shareowners and those of the SEC and other interested parties. The CD&A is, in the SEC's words, a narrative "discussion and analysis of the material factors underlying compensation policies and decisions" intended to provide context for the tabular compensation disclosure.

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Council members are therefore encouraged by the SEC's recent efforts to remedy pay disclosure shortcomings through a targeted review project. Widely publicized reports note that the SEC has identified significant deficiencies in CD&As and has sent the first of several waves of comment letters—said to number 300—seeking improved disclosure and additional information. Details in these reports also indicate that SEC staff is focusing on many of the same disclosure areas that the Council views as inadequate. The Council is optimistic that the staff's actions now will result in marked improvements for the 2008 proxy season.

The Council supports the SEC's efforts to improve the quality of the CD&A disclosure and make it more useful for shareowners. To that end, it urges the SEC to continue to focus on the following issues:

- Overall clarity and use of plain English: A study released by Mercer Human Resource Consulting last spring found that the length of proxy statements increased overall in 2007, with the average proxy being comprised of about 30 pages and the average CD&A being comprised of 6,141 words. The study also noted that using various “readability metrics,” to measure proxy statements, it found that “disclosures were more difficult to read than the Bible, the U.S. Constitution and *The New York Times*.” Lengthy CD&As filled with jargon and legalese obfuscate the key analysis of executive compensation philosophies and practices that allow investors to make informed decisions. Companies should be required to strictly adhere to the requirement in the SEC disclosure rules that calls for the use of plain English and they should ensure that their CD&A disclosures answer the “how” and the “why” questions rather than merely those addressing “who, what, where and when.” The answers to “how” and “why” should include a discussion of the parties and the process involved in setting executive pay. The CD&A provides an opportunity for companies to disclose whether or not they have disgorgement policies in place requiring executives to surrender their bonuses in the event of financial restatements. Council policy endorses these clawback provisions.
- Disclosure of specific performance targets: Disclosure of performance targets enables shareowners to evaluate the design of incentive programs as well as the fit between objectives used to motivate executives and the company's business goals. A study released by Watson Wyatt Worldwide in April 2007 found that more than half of 100 large companies studied did not disclose the actual goals on which they based rewards under their 2006 annual incentive plans or their goals for long-term incentive plans, presumably relying on the exclusion for confidential trade secrets or confidential commercial or financial

information. The Council believes this exclusion should be construed narrowly to prevent it from swallowing the rule, and companies should be required to justify their entitlement to it with specificity. Companies that are deemed by the SEC to be entitled to withhold the specific targets should be required to provide adequate “degree of difficulty” disclosure, including describing past experience with similar target levels and disclosing any inconsistencies between compensation targets and targets set in other contexts. Phrases often found in CD&A disclosures related to these explanations such as “intended to encourage superior performance” and “designed to promote excellence and motivate management” are grossly inadequate.

- Peer group comparisons and benchmarking: Benchmarking pay at 50 percent or higher leads to ratcheting up executive compensation. Accordingly, companies should disclose all other companies against which pay is benchmarked. Moreover, if the companies used for benchmarking pay differ from those used in the performance comparison graph required in the 10-K, a company should explain the reason for the difference and the rationale for choosing the pay comparison companies.
- Disclosure of termination and change-in-control arrangements: More uniform, tabular disclosure of these arrangements with totals for each NEO under each different triggering scenario (including gross ups and all other taxes payable by the company) would make this information much more user-friendly for investors.
- Compensation consultant’s role in setting pay: Companies are now required to identify the board’s compensation consultant, but other key information about consultants is missing. Specifically, companies should disclose information about the role of the consultant in determining the amount and form of compensation, the scope of the consultants’ assignment including a description of other business performed for the company and the compensation committee’s assessment of the consultant’s independence.
- Disclosure of material differences in packages awarded to NEOs: The SEC rules specify that disclosure in the CD&A “should be sufficiently precise to identify material differences in compensation policies and decisions for named individual and executive officers, however, if the policies are sufficiently similar, the officers can be grouped together.” Providing collective information on named executive officers (NEOs) often is insufficient. Overly large gaps in compensation between the CEO and other

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NEOs suggest poor compensation program design, a weak board and inadequate succession planning. Companies should adequately disclose each NEO's compensation and explain the reasons for the differences in the amounts awarded to each. This part of the disclosure also should include a discussion of how the compensation committee evaluates the internal pay relationship among its executives in setting pay and a discussion of how specific forms of compensation are structured and implemented to reflect the individual performance of NEOs.

Thank you for your work to date in this area and for considering our comments. We look forward to improved executive compensation disclosure in companies' 2008 proxy statements.

We would be happy to meet with SEC staff to discuss these issues. Council members must have access to clear, concise, detailed information about executives' pay packages in order to make informed decisions regarding their investments.

Sincerely,

A handwritten signature in blue ink that reads "Ann Yerger".

Ann Yerger
Executive Director, Council of Institutional Investors