



August 14, 2009

The Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Interim Final Rule for TARP Recipients

Dear Secretary Geithner:

I am writing on behalf of the Council of Institutional Investors (Council) to provide the Council's views and recommendations regarding the TARP Standards for Compensation and Corporate Governance regulations, which went into effect on June 15, 2009 (Interim Final Rule) and implement the executive pay standards legislated under the Emergency Economic Stabilization Act of 2008, as modified by the American Recovery and Reinvestment Act of 2009 (ARRA).

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 perspective on the Interim Final Rule.

The Council believes that institutions receiving federal assistance under TARP should be subject to strong oversight. Also necessary are: (1) meaningful restrictions to deter excessive risk-taking; and (2) incentives to ensure that managers act in ways that promote superior, sustainable, long-term shareowner value creation. The Council's thoughts and suggestions regarding the Interim Final Rule are as follows:

Bonus, Retention Award and Incentive Compensation Prohibition. The Council does not agree with ARRA's prohibition limiting incentive compensation to one-third of the employee's total annual pay. We recognize that Treasury did not suggest this restriction. Nonetheless, the Council must point out that the cap is at odds with the central tenet of compensation philosophy that says pay should be driven predominantly by performance.

In our view, the purpose of equity-based incentive compensation is to align the interests of executives and shareowners and to foster an in-it-for-the-long-haul worldview among managers. Therefore, minimizing the proportion of incentive pay in the executive compensation mix will have the negative unintended consequence of breaking the pay-for-performance and alignment link that is so crucial to prompting executives to think and act like long-term shareowners. Reasonable, effective, well-designed and properly-aligned incentives should be encouraged, not discouraged.

Golden Parachutes. Pay for failure is never appropriate. Therefore, the Council agrees that executives should not be entitled to severance payments in the event of termination for poor performance, resignation under pressure or failure to renew an employment contract. Company payments awarded upon death or disability should be limited to compensation already earned or vested.

Gross-ups. Gross-up payments are not performance-based and can hurt morale by implying that, as the late Leona Helmsley famously remarked, “only the little people pay taxes.” Senior executives should not receive gross-ups beyond those provided to all the company’s employees.

Clawbacks. We firmly agree that unearned bonus and incentive payments should be recovered or cancelled to the extent that it is feasible and practical to do so.

Perquisites. The Council believes that executives, not companies, should be responsible for paying personal expenses—particularly those that average employees routinely shoulder, such as family and personal travel, financial planning, club memberships and other dues. Total perquisites should be described, disclosed and valued.

Compensation Committees. We applaud the Interim Final Rule’s requirements that TARP compensation committees review semiannually senior executive pay plans for unnecessary and excessive risk, and provide annual descriptions and certifications regarding their evaluations and conclusions of risk assessment. We agree these narratives and certifications should be publicly disclosed in the annual proxy statement to enhance transparency and accountability and allow shareowners to make informed investment and voting decisions.

We were also pleased to see a discussion of compensation consultants in the Interim Final Rule. To reduce potential conflicts of interest in the pay-setting process, the compensation committee should disclose annually an assessment of its advisers’ independence, along with a description of the nature and dollar amounts of services that the company’s management commissioned from the advisers and their firms.

In addition, the Council believes that all TARP stakeholders would benefit if the final rule placed the following bulleted additional requirements on compensation committees. These stipulations would promote Treasury’s stated goals of encouraging sound risk management, tightly aligning company pay practices with shareowner interests and bolstering the stability of individual companies and the financial system at large. These guidelines are just as important and relevant today as when the Council articulated them to Treasury in our Nov. 20, 2008, letter on the executive compensation provisions of the TARP Capital Purchase Program.

- 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* 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.

Thank you for the opportunity to comment on the Interim Final Rule. If you have any questions, please contact me at 202-261-7088 or justin@cii.org.

Sincerely,



Justin Levis
Senior Research Associate