Via Email

November 1, 2012

Ms. Elizabeth M. Murphy
Securities and Exchange Commission
101 F Street, NE
Washington, DC 20549-1090

Re: File Number SR-NYSEArca-2012-105[1]

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors ("Council"), a non-profit association of corporate, public and union employee benefit plans with combined assets in excess of $ 3 trillion.[2] Council members are large, long-term shareowners responsible for safeguarding the retirement savings of millions of American workers. The purpose of this letter is to respond to your "notice to solicit comments" on the NYSE Arca, Inc. ("NYSE") proposed rule change to modify the NYSE Equities Rulebook to comply with the requirements of the Securities and Exchange Commission ("Commission") Rule 10C-1 ("Proposed Rule").[3]

At the outset, we note that the Financial Crisis Inquiry Commission ("FCIC") concluded:

> Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences. Often, those systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street.[4]

[1] Notice of Filing of Proposed Rule Change Amending NYSE Arca Equities Rule 5.3(k)(4) to Comply with the Requirements of Securities and Exchange Commission Rule 10C-1, Exchange Act Release No. 68,006 (Oct. 9, 2012), http://www.sec.gov/rules/sro/nysearca/2012/34-68006.pdf [hereinafter Proposed Rule].
[2] For more information about the Council of Institutional Investors (Council) and its members, please visit the Council's website at http://www.cii.org/become_a_member/become_a_member.
[3] Proposed Rule, *supra* note 1, at 1; 2.
[4] The Financial Crisis Inquiry Report *xix* (Jan. 2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

Significant responsibility for the faulty compensation systems identified by the FCIC resides with compensation committees that approved, sometimes following the recommendations of conflicted external advisers, poorly structured pay packages that encouraged a get-rich-quick mentality and overly risky behavior that helped bring the capital markets to their knees.[5] We, therefore, generally supported Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") which is the statutory authority for the Proposed Rule.[6]

Our support for Section 952 of Dodd-Frank was derived from the Council's membership approved policies which include a number of substantive provisions on "principles and practices for compensation committees,"[7] and, importantly, a detailed "independent director definition."[8] Combined those policies support fully-independent compensation committees to help ensure that executive pay decision-making is free of actual or perceived conflicts of interest that could color committee members' judgment.[9] Those policies also support the concept of minimizing and disclosing potential conflicts of interest among pay advisers.[10] In our view, pay advisers who, for example, count on lucrative actuarial or employee benefit contracts from senior management may be inclined to recommend overly-generous pay packages for those executives.[11]

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[5] Letter from Justin Levis, Senior Research Associate, Council of Institutional Investors to Ms. Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission 1 (Apr. 20, 2011) (Commenting on the U.S. Securities and Exchange Commission proposal that resulted in Rule 10C-1 implementing Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank)), http://www.cii.org/UserFiles/file/CII%20Letter%20on%20SEC%20Proposal%20on%20Comp%20Cmtes%20final.pdf.

[6] *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to The Honorable Christopher J. Dodd, Chairman, Senate Committee on Banking, Housing, and Urban Affairs 2 (Nov. 18, 2009) ("Reforms included in the discussion draft [the predecessor to Section 952 of Dodd-Frank] would help ensure that compensation committees are free of conflicts and receive unbiased advice."), http://www.cii.org/UserFiles/file/Dodd%20Reform%20Bill%20Discussion%20Draft%20Letter%2011-18-09.pdf.

[7] Council of Institutional Investors, Corporate Governance Policies **§ 5.5 Role of Compensation Committee** (updated Oct. 5, 2012), http://www.cii.org/UserFiles/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2010-5-12%20FINAL(2).pdf.

[8] *Id.* **§ 7 Independent Director Definition**.

[9] *See id.* **§ 5.5a Committee Composition** ("All members of the compensation committee should be independent.").

[10] *Id.* **§ 5.5g Outside Advice** ("the committee should annually disclose an assessment of its advisers' independence, along with a description of the nature and dollar amounts of services commissioned from the advisers and their firms by the client company's management"); *see also* Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 23 (July 2009), http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf (findings endorsed by Council membership include that "[c]onflicts of interest [of compensation advisers] contribute to a ratcheting-up effect for executive pay . . . [and] should be minimized and disclosed").

[11] *See, e.g.*, Investors' Working Group at 23.

Consistent with the Council's membership approved policies, the Council provides the following specific comments on the Proposed Rule:

Compensation Committee Director Independence

The Council generally supports the Proposed Rule's amendment to NYSE Equities Rule 5.3(k)(4) to require:

> [I]n affirmatively determining the independence of any director who will serve on the compensation committee of the listed company's board of directors, the board of directors must consider all factors specifically relevant to determining whether a director has a relationship to the listed company which is material to that director's ability to be independent from management, in connection with the duties of a compensation committee member including, but not limited to, the two factors that are set forth in proposed NYSE Arca Equities Rule 5.3(k)(4) and are explicitly enumerated in Rule 10C-1(b)(ii).[12]

We, however, would respectfully request that when considering the independence of any director who will serve on the compensation committee the final rule explicitly require the board to consider one additional factor—the "personal or business relationships between members of the compensation committee and the listed issuer's executive officers."[13] As suggested by the Commission in promulgating Rule 10C-1,[14] we believe that personal or business relationships between the director who will serve on the compensation committee and the issuer's executive officers are not uncommon and can result in the loss of the director's independence.[15]

[12] Proposed Rule, *supra* note 1, at 5.
[13] Listing Standards for Compensation Committees, Exchange Act Release No. 67,220, at 24 (June 20, 2012), http://www.sec.gov/rules/final/2012/33-9330.pdf.
[14] *Id.* ("the exchanges might consider that personal or business relationships between members of the compensation committee and the listed issuer's executive officers should be addressed in the definition of independence").
[15] Listing Standards for Compensation Committees, Exchange Act Release No. 67,220, at 24 (June 20, 2012), http://www.sec.gov/rules/final/2012/33-9330.pdf.

As explained in our comment letter to the Commission in response to the promulgation of Rule 10C-1:

> A director may lose objectivity in his/her oversight role if he/she, for instance, is associated with a firm that is a paid adviser to one of the company's *executive officers* or if he/she is associated with a non-profit organization that receives significant grants from one of the *company's officers.* Other examples include if the director is part of an interlocking directorate in which the *CEO or other officer of the company* serves on the board of a third-party entity (for-profit or not-for-profit) employing the director, or if the director delegates his/her decision making power as a director to *management*.[16]

While we acknowledge that the NYSE believes that it "interprets its existing director independence requirements as requiring the board to consider relationships between the director and any member of management in making its affirmative independence determinations," in our view, the importance of this factor requires that it be explicitly referenced in the final rule.[17] Longer term, we would respectfully request that the NYSE consider, perhaps as part of a future rulemaking, developing a more comprehensive and robust definition of an independent director that would be applicable to *all* board committees consistent with the best practices reflected in the Council's membership approved policies. To assist you in that regard attached to this letter for your consideration is the entire Council membership approved "Independent Director Definition."

Compensation Adviser Independence Factors

We generally support the Proposed Rule's requirement that "before engaging an adviser, the compensation committee must consider" the six independence factors enumerated by Rule 10C-1(b)(4).[18] We, however, would respectfully request that one additional factor be added to the list when determining an adviser's independence—whether the compensation committee consultants, legal counsel, or other advisers require that their clients contractually agree to indemnify or limit their liability.

[16] Letter from Justin Levis at 3 (emphasis added).
[17] Proposed Rule, *supra* note 1, at 16.
[18] *Id.* at 8.

We note that it has become standard practice for many compensation consultants to include third party indemnification and limitation of liability clauses in contracts with their corporate clients. Consistent with Council membership approved policies, we believe that those contractual provisions raise conflict of interest red flags that every compensation committee should consider as a factor in determining the independence of a consultant.[19] In our view, compensation advisers and their firms should stand behind their work and buy insurance coverage if concerned about potential liability.

We appreciate the opportunity to respond to the Proposed Rule. If you have any questions about this letter or need any additional information, please feel free to contact me at (202) 261-7081 or jeff@cii.org.

Sincerely,

Jeff Mahoney
General Counsel

Attachment

[19] Council of Institutional Investors **§ 5.5g Outside Advice** ("Companies should not agree to indemnify or limit the liability of compensation advisers or the advisers' firms.").