Via Facsimile

December 11, 2009

The Honorable Charles E. Schumer
313 Hart Senate Office Building
Washington, DC 20510-3202

The Honorable Michael D. Crapo
239 Dirksen Senate Office Building
Washington, DC 20510-1204

Dear Senator Schumer and Senator Crapo:

It is our understanding that Committee on Banking, Housing, and Urban Affairs Chairman Christopher J. Dodd has assigned you the task of working together to improve the provisions of the Restoring American Financial Stability Act ("Act") addressing corporate governance and strengthening of the Securities and Exchange Commission ("SEC"). As you consider those provisions of the Act, we write to highlight relevant findings and recommendations made by the Investors' Working Group ("IWG").

An independent blue ribbon panel of industry and market experts created by the CFA Institute Centre for Financial Market Integrity and the Council of Institutional Investors to study and report on financial regulatory reform from the viewpoint of investors, the IWG carefully considered the need to improve corporate governance and strengthen the SEC and other existing federal regulators. That consideration resulted in a number of findings and specific recommendations included in the IWG's July 2009 report – *U.S. Financial Regulatory Reform: The Investors' Perspective* ("IWG Report").

Corporate Governance

A summary of the IWG's findings on corporate governance include:

- The global financial crisis represents a massive failure of oversight.
- Vigorous regulation alone cannot address all of the abuses that paved the way to financial disaster.
- Shareowner-driven market discipline is also critical.
- Boards were often complacent, failing to challenge or rein in reckless senior executives who threw caution to the wind.
- Too many boards approved executive compensation plans that rewarded excessive risk-taking.
- Shareowners currently have few ways to hold directors' feet to the fire.
- The primary role of shareowners is to elect and remove directors, but major roadblocks bar the way.
- Federal proxy rules prohibit shareowners from placing the names of their own director candidates on proxy cards.
- Shareowners who want to run their own candidates for board seats must mount costly full-blown election contests.
- Another wrinkle in the proxy voting system is that relatively few U.S. companies have adopted majority voting for directors.
- Most public companies elect directors using the plurality standard, by which shareowners may vote for, but not against, a nominee.
- If shareowners oppose a particular nominee, they may only withhold their votes.
- As a consequence, a nominee only needs one "for" vote to be elected and unseating a director is virtually impossible.
- Poorly structured pay plans that rewarded short-term but unsustainable performance encouraged CEOs to pursue risky strategies that hobbled one financial institution after another and tarnished the credibility of U.S. financial markets.
- To remedy this situation, stronger governance checks on runaway pay are needed.

Consideration of the above findings led the IWG to propose the following specific recommendations to improve corporate governance:

1. In uncontested elections, directors should be elected by a majority of votes cast. At many U.S. public companies, directors in uncontested elections are elected by a plurality of votes cast. An uncontested election occurs when the number of director candidates equals the number of available board seats. Plurality voting in uncontested situations results in "rubber stamp" elections. Majority voting in uncontested elections ensures that shareowners' votes count and makes directors more accountable to shareowners. Plurality voting for *contested* elections should be allowed because investors have a more meaningful choice in those elections.

2. Shareowners should have the right to place director nominees on the company's proxy. In the United States, unlike most of Europe, the only way that shareowners can run their own candidates is by waging a full-blown election contest, printing and mailing their own proxy cards to shareowners. For most investors, that is onerous and prohibitively expensive. A measured right of access would invigorate board elections and make boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight of companies. Federal securities laws should be amended to affirm the SEC's authority to promulgate rules allowing shareowners to place their nominees for directors on the company's proxy card.

3. Boards of directors should determine whether the chair and CEO roles should be separated or whether some other method, such as lead director, should be used to provide independent board oversight or leadership when required. Boards of directors should be encouraged to separate the roles of chair and CEO or explain why they have adopted another method to assure independent leadership of the board.

4. Exchanges should adopt listing standards that require compensation advisers to corporate boards to be independent of management. Compensation consultants play a key role in the pay-setting process. But conflicts of interest may lead them to offer biased advice. Most firms that provide compensation consulting services to boards also provide other kinds of services to management, such as benefits administration, human resources consulting and actuarial services. These other services can be far more lucrative than advising compensation committees. Conflicts of interest contribute to a ratcheting-up effect for executive pay. They should be minimized and disclosed.

5. Companies should give shareowners an annual advisory vote on executive compensation. Nonbinding shareowner votes on pay would make board compensation committees more careful about doling out rich rewards to underperforming CEOs, and thus would avoid the embarrassment of shareowner rejection at the ballot box. So-called "say on pay" votes would open up dialogue between boards and shareowners about pay concerns

6. Federal clawback provisions on unearned executive pay should be strengthened. Clawback policies discourage executives from taking questionable actions that temporarily lift share prices but ultimately result in financial restatements. Senior executives should be required to return unearned bonus and incentive payments that were awarded as a result of fraudulent activity, incorrectly stated financial results or some other cause. The Sarbanes-Oxley Act of 2002 required boards to go after unearned CEO income, but the Act's language is too narrow. It applies only in cases where misconduct is proven—which occurs rarely because most cases result in settlements where charges are neither admitted nor denied—and only covers CEO and CFO compensation. Many courts, moreover, have refused to allow this provision to be enforced via private rights of action.

Strengthening the SEC and Other Existing Federal Regulators

A summary of the IWG's findings on strengthening the SEC and other existing federal regulators include:

- Since 1980, a dramatic shift in the financial regulatory system has occurred.
- Vigorous governmental oversight was abandoned as regulators placed their faith in the ability of markets to self-police and self-correct.
- Even as the credit crisis unfolded in early 2008, the prevailing view in the industry and among many agency chiefs and government leaders was that too much regulation, rather than too little, was eroding the competitiveness of U.S. markets.
- The financial crisis has revealed that insufficient and ineffective oversight, not over-regulation, paved the way to financial turmoil.
- Beyond a misplaced faith in markets, regulators lacked the will, knowledge and resources to flexibly respond to rapid financial innovation and market expansion.
- Poor funding and a lack of independence allowed an anti-regulatory ideology to permeate regulatory agencies.
- The Congressional appropriations process helped to undermine robust oversight.
- Fearful of political budgetary retaliation, agencies grew reluctant to exercise their authority fully in certain areas.
- It is no coincidence that these pockets of poor oversight proved to be sources of great risk.

Consideration of the above findings led the IWG to propose the following specific recommendations to strengthen the SEC and other existing federal regulators:

1. Congress and the Administration should nurture and protect regulators' commitment to fully exercising their authority. Congress and the Administration should amend statutory language establishing various financial regulators to prominently include provisions requiring that the President consider potential appointees' determination to exercise vigorous oversight and their commitment to the regulatory mission. Congress should be vigilant in exercising its general supervisory authority and thoughtfully carry out its obligation to provide advice and consent to ensure that nominees possess the resolve to regulate effectively.

The President, Congress and agency leaders must work to foster a culture of regulatory professionalism that rewards high-quality work and instills a community of purpose. Such a culture is rooted in steadfast devotion to vigorous oversight and enforcement. Regulators should be encouraged to exercise the greatest supervision where the need is greatest, including over the most complex and rapidly expanding institutions, products and markets. Resistance to regulation in these often highly lucrative areas is likely to be intense. Staff should be rewarded for asking tough questions, pursuing difficult cases and thinking outside the bounds of conventional wisdom. A healthy tension and skepticism between regulators and those they oversee should be promoted as a hallmark of exemplary regulation.

2. Regulators should have enhanced independence through stable, long-term funding that meets their needs. All federal financial regulators should have the resources and independence to fulfill their mission effectively without political interference or dependence on the firms they oversee. The IWG encourages Congress and the Administration to consider ways to develop mechanisms for stable, long-term funding. To ensure that funding keeps pace with rapid market changes and financial innovation, Congress, the Administration and regulators should periodically reevaluate the resources each agency needs to fulfill its mission. To the extent possible, agencies should have funding flexibility to respond to these changes on their own.

3. Regulators should acquire deeper knowledge and expertise. The speed with which financial products and services have proliferated and grown more complex has outpaced regulators' ability to monitor the financial waterfront. Staffing levels failed to keep pace with the growing work load, and many agencies lack staff with the necessary expertise to grapple with emerging issues. Political appointees and senior civil service staff should have a wide range of financial backgrounds. Compensation should be sufficient to attract top-notch talent. In addition, continuing education and training should be dramatically expanded and officially mandated to help regulators keep pace with innovation. Although we recognize that the "revolving door" between regulatory agencies and the private sector can lead to abuse, we believe that both the public sector and the private sector can benefit from people with experience in both. In particular, agencies should explore ways of recruiting individuals from the private sector to improve the regulators' ability to understand and keep up with complex financial and market innovations. And those who have served in regulatory agencies can assist market players in understanding the perspective of regulators and the need for regulations.

More details regarding the background and basis for the above findings and recommendations can be found on pages 8, 9 and 22 of the IWG Report available in electronic form at http://www.cii.org/UserFiles/file/resource%20center/investment%20issues/Investors'%20Working%20Group%20Report%20(July%202009).pdf.

Thank you for your consideration of the IWG views in connection with these two very important elements of regulatory reform. As always, we would welcome the opportunity to have members of the IWG discuss these issues with you or your staff at your convenience. Please feel to contact Jeff Mahoney at 202.261.7081 or jeff@cii.org to arrange for such a meeting or if you should have any questions or comments regarding this letter.

Sincerely,

Kurt N. Schacht, CFA
Managing Director, CFA Institute Centre for Financial Market Integrity
Co-Sponsor, Investors' Working Group

Joseph A. Dear
Chair, Council of Institutional Investors
Co-Sponsor, Investors' Working Group

cc: 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