The Investors' Working Group

May 26, 2010

The Honorable Christopher J. Dodd
Chairman
United States Senate Committee on
Banking, Housing, and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Richard Shelby
Ranking Member
United States Senate Committee on
Banking, Housing, and Urban Affairs
304 Russell Senate Office Building
Washington, DC 20510

The Honorable Barney Frank
Chairman, House Committee on Financial
Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Spencer Bachus
Ranking Member, House Committee
on Financial Services
United States House of Representatives
2129 Rayburn House Office Building
Washington, D.C. 2051

Dear Chairmen Dodd and Frank, and Ranking Members Shelby and Bachus:

Last year we served as co-chairs of the Investors' Working Group (IWG), an independent task force formed expressly to provide the investor perspective on future financial regulatory reform. This high-level task force issued a report—U.S. Financial Regulatory Reform: The Investors' Perspective [https://www.cfainstitute.org/ethics/Documents/us_investors_working_group_report.pdf]—that offers a number of recommendations intended to instill important investor protections into our financial markets system. It is in the capacity as co-chairs of this group and as former regulators, that we express the following views regarding the respective financial market regulatory bills passed by each House of Congress (the "Bills"). As we have noted previously, it is critical that regulatory reforms be properly structured if we are to avoid a repeat of the recent financial devastation.

As the Senate and House prepare to take these Bills to the Conference Committee, there are a number of provisions in the Bills that we wish to address. Among them, systemic risk and the resolution of failing systemically important financial institutions, and corporate governance measures are key to the objective noted above.

Systemic Risk Issues

Our work very much supported the critical need for effective systemic risk oversight. We have examined both the House and Senate bills in regards to systemic risk regulation, and based on the IWG's recommendations for broad, independent systemic oversight, we prefer the Senate's provisions to create an independent Office of Financial Research (OFR) and the Financial Stability Oversight Council (Council).

The Senate's three-pronged approach is the most closely aligned proposal to the IWG report and we believe it is workable. This is because it includes detection and monitoring within the OFR, mitigation of growing risks via the Council and, if needed, additional resolution authority shared among the Council and the Treasury. This allocation of authority appears to cover most aspects of an effective system. In particular, we find the independence and responsibilities of the OFR to be a key aspect of your plan consistent with the recommendations of the IWG.

Detection and Monitoring Authority of the OFR

While we support the provisions included in the Senate Bill, in our view, it must be clear that OFR is empowered to access information and conduct such investigation as it deems necessary in order to detect growing systemic vulnerabilities. This means freedom and autonomy to conduct comprehensive collection and analysis of systemic data, the ability to prioritize the issues it wishes to examine and ultimately, to freely make recommendations to the Council on corrective actions it considers necessary. Such independence is a key feature of the IWG proposals for systemic risk oversight.

We therefore encourage the Conferees to provide much greater clarification and assurance on these responsibilities. We do agree that the OFR should not force the Council to act on any particular recommendation. Yet, the OFR should be free to make whatever informed judgment it deems relevant on systemic risk mitigation, as economic and market circumstances warrant. Stated differently, if the Council is permitted to limit or control the investigative responsibilities of the OFR, directly or otherwise, we contend that the critical function of unbiased, timely detection and mitigation of systemic risk would be severely compromised.

Of particular concern is the language in the Senate Bill suggesting the Council will control the OFR's agenda and that it will be an office within (and potentially under the control of) the U.S. Treasury Department. We believe these issues should be clarified and that the OFR be free of commercial and political pressures exerted through the Council or the U.S. Treasury.

Some specific points we urge the Conference Committee to address include:

> i) adding provisions that would clarify the Council's ability to suggest, but not exclusively direct, the OFR on research topics,
> ii) adding provisions to ensure the adequacy and sustainability of the OFR's budget, and
> iii) providing clarifying language that would give the OFR full authority to independently review areas that appear to raise concerns about systemic vulnerability and to conduct data collecting and research in keeping with this authority.

Resolution Authority

Of equal importance for effective systemic risk management is the orderly unwinding of failed organizations that can impact or create systemic disruptions. Based on the IWG's specific recommendation to empower regulators with such resolution authority, we support the Senate provision to deal with failed systemically important non-banks through an orderly bankruptcy and liquidation process as preferable to the House's "living will" plan.

We have concerns about some aspects of the Senate Bill that would subject non-bank financial institutions deemed systemically important to Federal Reserve oversight. We find this to be a potentially troubling expansion of the Fed authority in this area. We thus support those portions of the Senate Bill that strictly limit the ability of the Federal Reserve, the Treasury and the FDIC to guarantee and provide assistance to failing financial institutions. We believe this process will reduce the moral hazard concern and more efficiently deal with speculative bubbles that evade OFR detection/mitigation.

Potential Expansion of Fed Powers

In general, the IWG expressed significant concerns about expanding Federal Reserve powers. Both of the Bills, however, appear to vest the Federal Reserve with certain responsibilities for identifying, monitoring and mitigating systemic risks. In addition to the potential shift to Fed supervision of certain nonbank financial companies, certain financial market utilities are being teed up for expanding Fed oversight.

As noted in several of our prior communications on regulatory reform, the Federal Reserve already has substantial, systemic, and vital responsibilities, including guiding monetary policy and managing the U.S. payments systems. Its role in failing to prevent certain practices as well as the failure of institutions under its watch have also raised serious questions about the appropriateness of having the Fed assume additional oversight responsibilities.

Finally, provisions in the Senate Bill that would allow the Fed to have what amounts to concurrent powers relating to systemic risk oversight appear to undermine the independence for systemic risk oversight vested in the Council and OFR. In other words, this provision would give the Fed a "backdoor" systemic risk oversight function. We strongly discourage this as inconsistent with the IWG's call for truly independent systemic risk regulation.

Corporate Governance

We support the provisions in both Bills that (1) reaffirm the authority of the SEC to issue a uniform proxy access rule that provides shareowners the right to place director nominees on the company's proxy; (2) give shareowners an annual advisory vote on executive compensation; and (3) require compensation advisers to corporate boards to be independent of management. We also support adoption of the Senate Bill's provisions requiring majority voting for the election of directors in contested elections, providing for clawbacks of unearned executive pay, disclosures regarding the roles of chairman and CEO, and prohibiting broker votes. All specifically endorsed by the IWG, these provisions would eliminate some of the existing impediments to shareowners' ability to effectively hold poorly performing directors accountable. Improving corporate governance is a critical market-based means of restoring trust in the markets and effectively reforming the financial system. We believe these provisions should be included in the final legislation.

Conclusion

We strongly encourage and support Congressional efforts in moving toward a final set of comprehensive regulatory reforms. The Senate Bill, combined with several elements of the House Bill provide the proper range of actions in our view. It is now a matter of bringing the major elements together, serving taxpayers and investors, and acting to prevent a repeat of the market turmoil which was disastrous for millions of Americans. In moving to this important conclusion, Congress must ensure that investors' interests remain a strong focus in the legislation that is ultimately enacted.

Thank you for your consideration. As you move closer to the final passage of this hallmark legislation, please do not hesitate to call upon us or members of the Investors' Working Group should you want further information or testimony on the important issues under consideration.

Sincerely,

William Donaldson, CFA
Chair, Donaldson Enterprises, and
Former Chair, U.S. Securities and Exchange Commission

Arthur Levitt, Jr.
Senior Advisor, The Carlyle Group and
Former Chair, U.S. Securities and Exchange Commission

CC: U.S Senate Members

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About the Investors' Working Group: The Investors' Working Group (IWG) is an independent, nonpartisan commission co-sponsored by the Council of Institutional Investors and the CFA Institute to recommend ways to improve the regulation of U.S. financial markets. The IWG was established to ensure that investor views are heard in debate about how to modernize the financial regulatory system. Co-chairs of the IWG are William H. Donaldson, CFA, and Arthur Levitt Jr.

About the IWG sponsors: The Council of Institutional Investors is a nonprofit association of public, union and corporate pension funds with combined assets that exceed $3 trillion. The Council is a leading voice for good corporate governance, strong shareowner rights and related investment issues. CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry.