

October 23, 2006

Ms. Nancy M. Morris  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-9303

Re: Executive Compensation and Related Person  
Disclosure; File No. S7-03-06

Dear Ms. Morris:

The Investment Company Institute<sup>1</sup> opposes the Commission's proposal to require a public company to disclose compensation information for certain highly compensated employees.<sup>2</sup> Investment companies (funds) are significant investors in public companies. Funds do not view information about the compensation paid to a company's non-executives as material to their decisions about whether to hold the company's stock or how to vote its proxies. Requiring disclosure of non-executive compensation could have serious negative implications for public companies, potentially leading to losses in value that would directly impact funds invested in those companies. Given that any investor benefit from this disclosure would be clearly outweighed by the negative impact of this requirement on public companies, the Institute urges the Commission not to adopt its proposal. Our position is explained more fully below.

### **Compensation Information About Non-Executives is Not Material to Investors**

Under the Commission's proposal, a public company would be required to disclose compensation information for up to three additional employees: (1) who have "responsibility for significant policy decisions" within the company, a significant subsidiary of the company, or a principal business unit, division or function of the company; and (2) whose total compensation

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<sup>1</sup> The Investment Company Institute is the national association of the U.S. investment company industry. More information about the Institute is available at the end of this letter.

<sup>2</sup> SEC Release Nos. 33-8735; 34-54380; IC-27470 (Aug. 29, 2006), 71 Fed. Reg. 53267 (Sept. 8, 2006) ("Proposing Release"). The Institute's initial comments focus on the proposal's application to individuals who are not executive officers, as this term is defined by Rule 3b-7 under the Securities Exchange Act of 1934. This would include individuals who are not executives for the company or its subsidiaries, as well as executive officers at the subsidiary level who do not perform policy making functions for the company. For ease of reference, we refer in this letter to all such individuals as "non-executives." We discuss the application of the proposal to executive officers of the company at the end of this letter.

for the last completed fiscal year was greater than that of any of the company's five named executive officers. The disclosure would consist of the employee's total compensation for that year and a description of his or her job position. According to the Proposing Release, this disclosure is intended to provide investors with a better understanding of the compensation structure of the company's named executive officers.

In our judgment, information about how much a public company pays its non-executives is not material to investors. By definition, an employee who is not an executive officer of the company does not serve a policy making function for the company.<sup>3</sup> He or she thus is not one of the key individuals charting the company's future course.

We strongly disagree with the Commission's suggestion that this information would be material to investors because it would assist them in understanding the compensation structure for the company's named executive officers. Non-executive compensation typically is not determined by corporate officials in the same manner as executive compensation. Rather, it is driven by market forces based on the specific functions that these employees perform or the uniquely valuable skills they possess. In many companies, especially larger ones, there also may be different compensation arrangements for different groups of non-executive employees. In the investment management industry, for example, portfolio manager compensation is likely to be tied to performance, while the pay packages of wholesalers is typically be based on sales. Non-executive compensation also can be highly variable, if it is based on commissions or other performance incentives. As a result, there may be little continuity from year to year in the individuals whose compensation would have to be disclosed. These factors illustrate why juxtaposing non-executive compensation with the compensation paid to the company's named executive officers would be of little utility to investors and could potentially be misleading.

In contrast, information about the amount and structure of the compensation paid to a company's key executive officers *is* material to investors. The Commission's recent overhaul of its executive compensation disclosure rules – which the Institute strongly supported – will result in detailed disclosure regarding the pay packages awarded to key company executives and the compensation policies applicable to those executives.<sup>4</sup> This information informs investor decisionmaking because it sheds light on whether the company has aligned the interests of its key policy makers with those of its shareholders and whether these policy makers are properly incentivized to maximize value for shareholders.

Like the Institute, the overwhelming majority of commenters on the Commission's initial proposal indicated that information about non-executive compensation is not material. The Commission has attempted to address this concern by proposing to limit the scope of the requirement to employees who have "responsibility for significant policy decisions." There are several glaring problems with this approach.

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<sup>3</sup> See Rule 3b-7.

<sup>4</sup> See Letter from Elizabeth R. Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated April 10, 2006.

First, the Proposing Release states that “[r]esponsibility for significant policy decisions could consist of, for example, the exercise of strategic, technical, editorial, creative, managerial, or similar responsibilities.” This interpretation of relevant policy responsibility is so broad as to almost be meaningless. Most highly compensated employees at any company could be said to exercise some such responsibilities. The discussion in the Proposing Release of how the new standard would apply to investment professionals is a case in point. According to the Proposing Release, a trader or portfolio manager generally would not be deemed to have responsibility for significant policy decisions simply by performing the duties associated with that position. If the individual has broader job duties – such as oversight of a group of equity funds – he or she may be considered to have such responsibility. A portfolio manager tasked with overseeing a group of funds is likely to play a lead role on issues relating to fund performance, compliance with regulatory requirements, and the job performance of more junior portfolio managers. He or she also is likely to be involved in any decisions relating to new product offerings in that area. While these duties certainly could be said to involve the exercise of strategic and managerial responsibilities, these are *business and operational* responsibilities, rather than responsibilities relating to significant “policy” decisions.

Second, the Commission has failed to draw a discernable distinction between *employees with responsibility for significant policy decisions at the company* on the one hand and *employees who perform a policy making function for the company* on the other hand. It is certainly true that companies – particularly large companies – have employees who contribute to the development of company policy but whose involvement does not rise to the level of company policy making. The Institute is hard pressed to understand how compensation information for “contributing” employees would be meaningful to investors.

Third, the disclosure requirement would apply to employees with responsibility for significant policy decisions at a significant subsidiary or at a principal business unit, division, or function of the company. Investors are unlikely to view as meaningful any information about individuals setting policy at this level, particularly given the broad definition of “significant subsidiary.”<sup>5</sup> This would be especially true for large accelerated filers, which may have several significant subsidiaries or business units. The Commission also has failed to explain how this information would meet the stated objective of this disclosure requirement, which is to provide investors with a better understanding of the compensation earned by the company’s named executive officers.

It appears that the Commission is under the impression that investors are seeking compensation information about employees other than a company’s key executive officers, simply because they are highly compensated. As the trade association representing many of the largest investors in U.S. public companies, we can tell you plainly that our members are not.

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<sup>5</sup> This would certainly be the case in situations where the public company has no influence or control over the compensation arrangements of its subsidiaries. This circumstance typically arises in acquisition settings in which the acquiring public company essentially becomes a partner to the acquired subsidiary and structurally relinquishes any rights to oversee the subsidiary’s allocation of operating expenses (including compensation) or recapture any portion of such expense as cash flow or profit.

Based upon the comments that the Commission received on its initial proposal, compensation information for these employees seems to be of interest primarily to activists seeking to compel changes in corporate behavior that they believe to be necessary or desirable. This agenda, whether or not we agree with it, does not reflect the purpose of the disclosure requirements in the federal securities laws, which is to provide meaningful information to *investors* so that they may make informed investment decisions.

### **Disclosure of Non-Executive Compensation Could Have Serious Negative Implications for Public Companies**

The Institute strongly believes that requiring disclosure of non-executive compensation could have serious negative implications for public companies. Any resulting losses in public companies' values would have a direct adverse impact on funds' investments in those companies and, ultimately, on fund performance. The Institute is not alone in its view. In fact, the Commission has already received extensive comment from individual companies, business associations, law firms, bar associations, and others describing the potential harms associated with this requirement.

In particular, disclosure of the total compensation paid to selected non-executives – even if those individuals are identified only by job description – could harm a public company by making it easier for competitors to lure away the company's top talent. In the investment management industry, competition for top-performing investment professionals is fierce. Requiring this disclosure would put publicly traded fund advisers at a competitive disadvantage by making it harder for them to attract and retain talented money managers who are in equally high demand by hedge funds and private fund management firms. This same concern would hold true for any publicly traded company whose most important asset is its employees. For example, a competitor might be able to use this information to identify and lure away the chief scientist of a biotechnology company or a technology company's top engineer, which could have a devastating effect on the company's research and development program. This would have the perverse effect of hurting the very shareholders that the Commission seeks to protect.

Creating imbalance in the competition for top talent is not the only way in which the proposed disclosure could harm public companies. It is also possible that a top employee might choose to leave a public company rather than having his or her compensation publicly disclosed. Departures for either reason could cause the company to lose customers and revenue. Moreover, the disclosure could negatively impact employee morale and potentially lead to pressure on the company for pay increases to other employees. All of these potential effects would be particularly acute for companies whose primary competitors are private companies or non-U.S. companies that would not be subject to the same disclosure obligation. In this regard, the Commission's proposal could have the anomalous effect of encouraging companies to consider going private or moving their operations offshore.

Like other commenters, the Institute has serious concerns that administrative compliance with this requirement could be very burdensome and costly for public companies, with an attendant negative impact on their bottom lines. Companies would be required to track all forms

of compensation for a greater number of employees. For many smaller companies, this tracking would have to be done manually. For companies with numerous subsidiaries and lines of business, including many large accelerated filers, this tracking could be very onerous and potentially involve a considerable number of employees. For companies with employees in foreign jurisdictions, valuing compensation could raise difficult valuation issues.

The Commission's modifications to its initial proposal do not alleviate the problems associated with this proposed disclosure obligation and, in some cases, could exacerbate them. For example, companies would have the added burden of determining, from year to year, which employees have responsibility for significant policy decisions at the company, a significant subsidiary of the company, or at a principal business unit, division, or function of the company. This would be particularly challenging for companies with numerous subsidiaries and lines of business. Additionally, the Commission's possible application of this requirement only to large accelerated filers simply would make these companies more vulnerable to many of the harms and burdens detailed above (*e.g.*, strengthening the ability of competitors to hire away the company's top talent, losing employees to companies where the disclosure is not required, and imposing complex and costly tracking requirements).

### **Requiring Compensation Disclosure for Additional Executive Officers of a Company is Not Necessary to Achieve the Commission's Goal**

The Commission proposes to expand its initial disclosure proposal to include highly compensated employees of a public company who are executive officers of the company.<sup>6</sup> This could result in disclosure of the total compensation paid to three additional executive officers of the company apart from its five named executive officers.

The Institute believes that this disclosure is not necessary to achieve the Commission's stated goal of providing investors with a better understanding of the compensation earned by the company's named executive officers. Funds and other investors should have a very clear understanding of such compensation once companies are complying with the Commission's recent amendments to its executive compensation disclosure rules. Under the amended rules – which the Commission itself described as a “thorough rethinking” of the disclosure requirements in this area – investors will be given detailed quantitative and qualitative information about the various elements of the pay packages awarded to a public company's named executive officers. The Commission also took pains to ensure that investors will receive clear and complete information about these compensation awards, by imposing on the company an affirmative obligation to provide a narrative description of “any material factors necessary to an understanding” of the quantitative disclosure contained in the compensation tables.<sup>7</sup> In light of these new requirements, we do not believe that the proposed disclosure is warranted.

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<sup>6</sup> This would include any executive officer of a subsidiary who performs a policy making function at the company level. *See* Rule 3b-7.

<sup>7</sup> *See* Item 402(e)(1) of Regulation S-K.

## **Compensation Disclosures Should Continue to Focus on a Public Company's Named Executive Officers**

For almost thirty years, the Commission has required public companies to disclose compensation information for five executive officers who are identified by name. As part of its recent rulemaking, the Commission: (1) modified the makeup of this named executive officer group to include a company's principal financial officer; (2) greatly expanded the level of detail required about the compensation paid to each of these named executive officers; and (3) reaffirmed that such disclosure should continue to be limited to five executive officers, after having specifically requested comment on whether this number should be increased. Taken together, these decisions by the Commission represent a careful balancing of the needs of investors and public companies, and a recognition that what is most valuable to investors is clear and complete disclosure of the compensation paid to a very select group of executive officers – the key decision makers – within each company. In our judgment, any effort to expand compensation disclosure beyond this group of key executives could disrupt this balance and have the unfortunate effect of becoming “disclosure for disclosure's sake.”

We are also concerned that requiring compensation disclosure for employees beyond the “key decision makers” could start down a slippery slope, without any clear line as to where the disclosure should stop. We note that, over the years, various calls have been made to require disclosure of the compensation earned by fund portfolio managers and even executives of *private* advisory firms that manage funds. It is very important to recognize that the advocates favoring such disclosure may have diverse agendas quite distinct and apart from the purpose of the federal securities laws – that of ensuring that individual investors and the marketplace at large have access to meaningful information about all public issuers so that investors are able to make sound investment decisions.

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As large investors in the public securities markets, funds – and, by extension, fund shareholders – have a vested interest in ensuring that the Commission's disclosure rules continue to strike the proper balance between the information needs of investors and the impact on public companies of providing that information. On behalf of its members, the Institute urges that any change to the Commission's longstanding policy in the area of compensation disclosure should be undertaken only where the value of the disclosure to investors would clearly outweigh any negative impact on public companies. The current proposal falls woefully short of that standard.

The Institute appreciates the opportunity to comment on this proposal. If you have any questions about our comments or would like any additional information, please contact me at 202/326-5815, Amy B.R. Lancellotta at 202/326-5824 or Rachel H. Graham at 202/326-5819.

Sincerely,

/s/

Ms. Nancy M. Morris

October 23, 2006

Page 7 of 8

Elizabeth R. Krentzman

General Counsel

cc: The Honorable Christopher Cox  
The Honorable Paul S. Atkins  
The Honorable Roel C. Campos  
The Honorable Annette L. Nazareth  
The Honorable Kathleen L. Casey

John W. White, Director  
Division of Corporation Finance

Andrew J. Donohue, Director  
Division of Investment Management

Ms. Nancy M. Morris

October 23, 2006

Page 8 of 8

### **About the Investment Company Institute**

ICI members include 8,821 open-end investment companies (mutual funds), 654 closed-end investment companies, 234 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$9.468 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 89.5 million shareholders in more than 52.6 million households. In addition, the ICI's membership includes 171 associate members, which render investment management services exclusively to non-investment company clients.