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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; Sec. Act. Rel. 33-8735, File No. S7-03-06 (Aug. 29, 2006)*

Dear Ms. Morris:

I am the Chairman and Chief Executive Officer of Legg Mason, Inc. On behalf of Legg Mason, I want to commend the Commission for its accomplishments in enhancing the transparency of executive compensation, but also respectfully to urge the Commission not to adopt its current proposal to require public companies to disclose compensation information for certain highly compensated employees other than such companies' "named executive officers" ("NEOs").

Legg Mason of course accepts that free enterprise can and should be subject to regulation for good and sufficient reason, but it also believes that the regulatory solution should have a rational relationship to the perceived problem and should not cause adverse effects that outweigh its anticipated benefits. Legg Mason believes, however, that the Commission's proposal violates these bedrock principles.

First, the notion of disclosing non-executive compensation bears at best a tenuous relationship to the rationale articulated by the Commission of "assist[ing] in placing in context and permit[ting] a better understanding of the compensation structure of the [NEOs]."

- Parent companies typically negotiate the pay of senior executives at subsidiaries very much at arm's length because all savings go to the parent company's bottom line – to the shareholders. The essence of Legg Mason's growth strategy, and what has made Legg Mason as successful as it is, *for the benefit of our clients and*

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our shareholders, is that it acquires existing successful businesses, with very talented personnel, and then lets them retain substantial autonomy. The economic corollary of this business model is that most of Legg Mason's principal subsidiaries have agreements with the parent company that provide for payments to Legg Mason based on gross revenues, with the result that spending decisions of the subsidiaries, including about how the subsidiaries compensate their employees, do not and can not affect the results of the parent or its shareholders. So even applying a "materiality writ large" litmus test, it is *not* material to shareholders how much any subsidiary pays any of its employees, even the most successful ones. And this model works.

- More generally, disclosure of non-executive compensation, especially at the subsidiary level, may not reveal anything, contextual or otherwise, about executive compensation. Employees at subsidiaries do not direct the payment of their own compensation except through market forces (*i.e.*, not through any process implicating self-dealing concerns); their compensation is typically not determined by the same body (*i.e.*, the compensation committee of the parent company's board) that determines the compensation of NEOs; their compensation is typically focused on performance at the subsidiary level (and may have little to do with the profitability of the organization as a whole); and their compensation may fluctuate dramatically year-to-year.

- Quite apart from the foregoing, the proposed additional disclosure provides little context to the disclosure of NEO compensation in that it discloses nothing about the universe of employees earning more than the lowest paid NEO (*i.e.*, whether there are three or 20 such persons), and provides no historical information or contextual details regarding these individuals' compensation. Indeed, employees can move in and out of this three-person group depending on the significance of any particular subsidiary over time, and on fluctuations in a subsidiary's profitability.

- The Commission's recent enhancements to executive compensation disclosure provide superior sources of contextual information. The Compensation Disclosure and Analysis that companies will be required to provide under the recent amendments already mandates "narrative disclosure that *puts into context* the compensation information provided elsewhere." Sec. Act Rel. 33-8732A (September 8, 2006) (emphasis added). We are aware of no reason to suppose that this straightforward, principle-based approach will be inadequate to the Commission's stated objective. Furthermore, the enhanced disclosure of NEO compensation at similarly-situated public companies that will occur as a result of the recently approved rules will provide especially useful comparative contextual information to shareholders.

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Second, and in any event, the Commission's proposal harbors very predictable and harmful collateral consequences for public companies and ultimately the investors whose interests the Commission seeks to advance:

- The particularized disclosure being proposed *will* introduce a material competitive imbalance between publicly-owned companies and foreign and privately-owned entities. Some of the individuals potentially affected by the proposal have affirmatively chosen not to serve as executives at the public company level; and many of them strongly object to the fundamental loss of privacy contemplated by the proposal. Thus, as a result of the proposed rule, some of these exceptionally talented professionals who have chosen to live out of the public eye will likely be *driven* to the foreign and privately-owned sector, and those who aren't will likely be *lured* by foreign and privately-owned entities equipped with a substantial informational edge about what it takes to lure them. This will *harm* shareholders in a profound and enduring way.
- Even for those who choose to work out a way to remain employed by a subsidiary of a publicly held company, the proposals would create a highly dysfunctional incentive for the most talented persons to avoid management or policy responsibilities, which likewise cannot be in the long-term interests of shareholders.
- These concerns are especially acute in the asset management industry, which employs many professionals who manage portfolios but also may also exercise some policy functions, for example, as Chief Investment Officers overseeing groups of portfolio managers. The work these professionals perform is highly portable, and these individuals can be transplanted with ease to private companies and hedge funds willing to afford them the same platform and professional opportunities, without the burdens associated with the proposed rules.
- The ramifications extend beyond personal decision-making. For instance, as noted, it is a central aspect of Legg Mason's acquisition strategy to acquire successful existing businesses, but to preserve, to a large extent, their autonomy; similarly, it is a central tenet of Legg Mason's business philosophy that many policy decisions affecting its subsidiaries be made at the subsidiary level, rather than dictated by the parent company. The proposed rules are fundamentally antithetical to and threaten to undermine our considered – and successful – approach to realizing value for our shareholders.

American businesses, and service industries such as the asset management industry in particular, are dependent on human capital. Even if the additional disclosures proposed by the Commission have a marginal tendency to provide "context" to the disclosure of NEO compensation—and we are not convinced that they do—it seems appropriate to question whether that modest benefit is worth the cost of the most talented professionals making decisions about where they work and what they do in their jobs, or indeed fundamentally altering how large and complex business organizations structure themselves, based on misguided, extraneous considerations.

Third, these questions about the need for and efficacy of the Commission's proposal are especially problematic when one considers that, with minor modifications, the proposed rules can accomplish the Commission's objective of supplying "context" to the disclosure of NEO compensation while avoiding or significantly mitigating this serious collateral damage.

If the Commission continues to believe that additional rule-based guidance is needed, we respectfully urge it to consider, while preserving the structure of the current proposal, eliminating the requirement for disclosure of the specific compensation of the three highest paid non-NEOs and instead providing the desired context about a firm's compensation practices by requiring disclosure of the total number of employees who have responsibility for significant policy decisions at a significant subsidiary or a principal business unit, division, or function and who receive more compensation than the lowest paid NEO, and the total number of such persons who receive more compensation than the principal executive officer.[1] The benefits of this proposed modification are that: (a) it *better* achieves the Commission's expressed objectives because it is *more* inclusive than the proposed rule where it counts – it provides a more complete picture of non-NEO compensation in that it is not arbitrarily limited to three non-NEOs; (b) at the same time, it substantially limits some of the most profoundly adverse collateral effects of the current proposal; and (c) it retains the basic structure and conceptual underpinning of the current proposal. If it turns out to be inadequate to its intended task, the framework remains in place for modifying it; if it wreaks unintended negative consequences that outweigh its benefits, it can be pared back even further.

Finally, if the Commission determines to approve the proposed rule despite its predictable unintended costs, we respectfully urge that the Commission consider two concerns. First, that implementation be delayed for one year and applied prospectively. Public companies are already grappling with the burdens of implementing the recently approved disclosure requirements, and they and the professionals who advise them will need substantial time to address responsibly the added layers of complexity entailed in complying with the proposed rule, not to mention addressing the competitive imbalances, compensation issues and privacy concerns that the proposed rule will occasion.

Second, we urge the Commission to be clear in any final rule that the disclosure applies only to persons with "responsibility for significant policy decisions."

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[1] *E.g.*, "We have 20 employees with responsibility for significant policy decisions at a significant subsidiary who received total compensation greater than that of the lowest paid named executive officer, and, of that group, 10 received total compensation greater than that of the CEO."

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Our concern arises from the proposed rule's ambiguity in referring variously both to employees with "*responsibility for significant policy decisions,*" and employees who "*exert significant policy influence*." Large public companies may have a wide range of employees who exert influence over significant company policies, but who nonetheless do not have responsibility for ultimately determining such policies. Requiring disclosure of the compensation of persons who merely exert influence over policy decisions would seem to provide little in the way of "context" to a company's disclosure of NEO compensation; worse yet, determining who might qualify under such an amorphous and subjective standard would pose profound difficulties for public companies and those who advise them.

On behalf of Legg Mason, I want to thank you for considering our views on this matter.

Your sincerely,

Raymond A. Mason

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
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