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Investors call upon SEC to adopt rule allowing shareholder advisory vote on executive compensation

The ever-rising tide of U.S. senior executives' compensation has prompted a group of major international investors co-ordinated by Universities Superannuation Scheme (USS) to write a letter to Christopher Cox, Chairman of the SEC, calling upon the United States to require—or at least permit—shareholder advisory votes upon a company's compensation policies at the Annual General Meeting.

"We concur with the comments President Bush made last week that compensation of corporate executives should be based on their performance and not decided by government regulation," said Peter Moon, Chief Investment Officer at USS. "Use of advisory shareholder votes on executive compensation has been a successful market-based means of promoting development of a 'pay-for-performance' company culture." The USS is the second-largest pension fund in Great Britain with £28,000 million (\$56 billion) under management.

Thirteen funds from five countries speaking for US \$1.5 trillion joined to press for advisory votes on executive pay at US companies. The initiative is a product of the ad hoc International Roundtable on Executive Remuneration, spearheaded by the USS and coordinated by governance advisors Reinhart Institutional Investor Services and Investment Initiatives, LLC.

"The primary purpose of an advisory shareholder vote on executive compensation is to enhance the dialogue between the Board and the shareholders on the general remuneration policy of the company. It is therefore not so much about fine-tuning individual salaries for individual directors, but more about a better link between pay and performance" according to Eugene Rebers, Senior Counsel at ABP Investments. Added Gerard Fehrenbach, Senior Advisor Responsible Investment at the Dutch fund, PGGM, ". . . we see an advisory shareholder vote on executive compensation as an essential and imperative step towards improving shareholders' rights in the United States in general".

The letter calls upon the SEC to allow a system which would be similar to that now in place in the U.K., Australia, and Sweden, in which shareholders would get to reflect their views upon a company's compensation policies by indicating their acceptance or disapproval of the board of directors' compensation report. The vote would not be binding upon the board, but would indicate the level of shareholder concern directly. Such a system would give shareowners in American companies their first opportunity to express their concern with a company's compensation, an issue which has become a central concern not only to investors but to American society at large, as a chorus of opinion, not only from Congress, but also from President Bush, as clearly indicated in his address to the nation from Wall Street last week.

As the investors indicate clearly in their letter, experience with this system in the U.K. and in Australia, countries with legal systems and markets similar to that of the U.S., has been strongly positive, and has led to increased dialogue between directors and investors, rather than the confrontation which is feared by many U.S. corporations. On the contrary, the only ways investors in the United States now have to express their discontent with excessive compensation is to engage in lawsuits, withhold their votes from directors—a purely symbolic action at most companies which has the added disadvantage of being unfocused and non-specific—or to attempt to transfer control of the company to a hostile bidder. None of these methods convey a clear message, all of them have a limited chance of making an impression, are disruptive, and they all harden the line between shareholders and the board and make dialogue difficult.

Among the virtues specified in the letter to Chairman Cox are the following:

- Advisory votes have led to consultations between companies and their major shareholders at an estimated 90% of British companies.
- There has been an increased emphasis upon long-term performance targets, and use of company-specific circumstances and strategic plans in constructing compensation plans since this regime came into place.
- The quality of disclosure of compensation arrangements has improved.
- All shareholders get to be heard on these issues, rather than merely the largest or most activist shareholders.
- Actual rejection of the compensation plans has been relatively rare, because companies have refashioned them to be more in accord with investors' stated concerns.
- The dialogue between management and shareholders has spread to include discussion of other issues of concern to shareholders.

Investors signing the letter in addition to USS are ABP of the Netherlands, the State of Connecticut Retirement & Trust Funds, the Co-operative Insurance Society, F&C, Hermes, the Local Authority Pension Fund Forum of the U.K., Morley Fund Management, PGGM of the Netherlands, the U.K.'s Railpen, the Shell Pensions Fund, Standard Life Investments, and UniSuper of Australia. All of the non-US investors have direct experience with advisory or in the case of the Netherlands mandatory voting on compensation in their home markets and have found it strongly positive.

Recipients of the letter included the other SEC Commissioners, Rep. Barney Frank, Chairman of the House Financial Services Committee, Senator Christopher Dodd, Chairman of the Senate Banking Committee, John Thain, CEO of the N.Y. Stock Exchange, and Robert Greifeld, CEO of NASDAQ.

A copy of the letter is available at:

<http://www.reinhartinvestor.com/WebAdmin/Files/SECLetter.pdf>

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