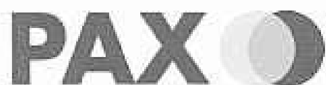

September 2, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Release Number: 34–60218, File No. S7-12-09

Dear Secretary Murphy,

On behalf of Pax World Management Corp. (Pax World), adviser to Pax World Funds, with over $2.3 billion in assets under management, I am writing to submit comments on the Securities and Exchange Commission's (SEC) proposed rule entitled "Shareholder Approval of Executive Compensation of TARP Recipients," Release Number 34–60218, File No. S7-12-09, issued July 1, 2009.

Pax World supports the proposed rule requiring TARP recipients to provide a shareholder advisory vote to approve the compensation of executives as disclosed in the Compensation Discussion & Analysis. This is relatively uncontroversial and, among TARP recipients, will at least help assure a modicum of accountability and may even reduce the incentive for excessive risk taking by traders and lenders that helped pave the way for the financial crisis. Even more importantly, however, Pax World strongly encourages the SEC to extend the advisory vote on executive compensation as a requirement for all publicly traded companies. We also urge the SEC to consider requiring separate votes on specific categories of executive compensation that may misalign incentives of management and shareholders, or that have no discernible link to performance.

In a speech on June 10, 2009, Treasury Secretary Timothy Geithner stated that "this financial crisis had many significant causes, but executive compensation practices were a contributing factor."[1] The Financial Stability Forum (FSF), which comprises senior representatives of national financial authorities, regulators, and standards-setting bodies, noted in its Principles for Sound Compensation Practices that "[C]ompensation practices at large financial institutions are one factor among many that contributed to the financial crisis that began in 2007…perverse incentives amplified the excessive risk-taking that severely threatened the global financial system and left firms with fewer resources to absorb losses as risks materialized." "…governance is more likely to be effective if the firm's stakeholders, particularly shareholders, are engaged with compensation… For example, each year shareholders might vote on a nonbinding resolution to approve executive compensation."[2]

The financial crisis also created a laboratory to see how CEO pay behaved under stress, and the answer was that, while the rest of the economy suffered, most CEOs felt no pain. A report on 2008

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[1] Statement by Treasury Secretary Timothy Geithner on Compensation, June 10, 2009
[2] Financial Stability Forum, "FSF Principles for Sound Compensation Practices," 2 April 2009.

CEO compensation from The Corporate Library (TCL), which surveyed over 3,000 U.S. and Canadian companies, found the following:

1. The compensation of 29 CEOs increased in 2008 by more than 1,000 percent.
2. Nearly ¾ of CEOs had increases in base salary, and only 3% saw a decrease.[3]

In a year in which so many companies had dismal performance, a mere 3 percent of CEOs saw a decrease in pay. Providing shareholders with an advisory vote on compensation will help promote accountability and address this "heads I win/tails you lose" system of runaway executive compensation that increasingly seems to reward failure as much as success.

Pax World believes that requiring all companies to submit to an annual shareholder advisory vote on executive compensation will begin to address the role that compensation played in this most recent financial crisis. Going forward, it will also promote accountability to shareholders, enhance communication between directors and shareholders, improve corporate governance and will likely also contribute to improved corporate financial performance over time.

An advisory vote on executive compensation promotes accountability of compensation committee members to shareholders. While an advisory vote does not bind the company, it provides a much-needed public referendum that CEOs and other named executives have never had. It also encourages compensation committees to create compensation packages that provide incentives for long-term growth that benefits investors. An advisory vote on executive compensation is one of the best ways to promote board accountability to shareholders, as it is held in a public forum that all shareholders or potential shareholders may view.

Accountability, governance, and risk

Accountability is also an effective tool to curb the increasing tendency toward managerial risk-taking that played such a prominent and causal role in the recent financial crisis and the continuing recession. According to governance expert Lucian Bebchuk and co-author Holger Spamann, executive compensation in the form of shares in bank holding companies or options on such shares created powerful incentives for executives to take excessive risks in the form of increased debt issues, making executive pay in banking contingent on increasing leverage.[4] The results were disastrous. While the Bebchuk/Spamann paper focuses on executive pay in banking, the findings could be just as valid for corporations in any sector. We believe that the prospect of facing a shareholder vote on executive compensation each year could help mitigate the motivation to take ever-increasing risk on the part of executives whose incentive pay too often increases with higher leverage.

While we believe it is necessary, an annual vote is unlikely to be sufficient to truly curb excessive executive compensation, or the risks that executive compensation creates in the financial sector specifically. We also believe that the SEC should consider rulemaking based on the Financial Stability Forum's (FSF) recommendations on "effective alignment of compensation with prudent

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[3] *Paul Hodgson and Greg Ruel, "CEO Pay 2008: The Corporate Library's CEO Pay Survey 2008," The Corporate Library, n.d.*

[4] Bebchuk, Lucian and Holger Spamann, "Regulating Bankers' Pay," The Harvard John M Olin Discussion Paper Series Discussion Paper No. 641, June 2009.

risk taking".[5] Briefly, those principles include (1) adjusting compensation for all types of risk, (2) compensation outcomes must be made symmetric with risk outcomes, (3) payout schedules should be sensitive to the time horizon of risk, and (4) types of compensation should be aligned with risk. Just this month, the United Kingdom's Financial Services Authority (FSA) announced new compensation rules based on the FSF's principles, requiring that specified financial institutions adjust compensation to better reflect current and future risk.[6] We believe that the FSA's new rules provide a much more effective framework for alignment of both short- and long-term financial risks with remuneration of executives and key employees.

A better way to communicate

An advisory vote on compensation provides a better way for shareholders and directors to communicate about compensation. Currently, shareholders literally have no means to register their concerns regarding executive compensation. Certainly, director elections do not provide an avenue for such communication. Withholding votes from directors – a shareholder's only option (in most cases they cannot even vote "NO") – is hardly a clear or effective means of communication. Even withholding votes from the entire compensation committee or the entire slate can be interpreted in many ways, and would not necessarily register any specific concerns about executive compensation. An advisory vote on executive compensation is the only practical means of allowing shareholders to provide input and feedback, in a meaningful way, on a company's compensation practices.

Moreover, we also believe that the SEC should consider amending the rule to require separate shareholder votes on certain categories of executive compensation: incentive compensation that is likely to misalign executives' incentives with shareholder interests, and executive compensation factors, other than salary, that are not aligned with performance or shareholder interests. These two items are discussed below.

Misaligned incentive pay. In July 2009, the House of Representatives passed HR 3269, the Corporate and Financial Compensation Fairness Act of 2009. This legislation, if it becomes law, will not only require an annual say on pay advisory vote for all public companies, but will also mandate a separate vote on golden parachutes, recognizing that in many instances managers negotiate larger payments at the time of a merger, which tends to skew incentives toward mergers in ways that may not be in the best interests of shareholders. A study from researchers at NYU[7] found that in 27% of the 300 mergers studied, CEOs negotiated large cash payments that increased already-existing golden parachutes. According to the authors, "Regression estimates suggest that target shareholders receive lower acquisition premia in transactions that involve extraordinary personal treatment of the CEO." The NYU study covered mergers in the late 1990s, but it is clear from the recent SEC complaint against Bank of America for making materially false and misleading statements regarding bonuses paid at Merrill Lynch that extraordinary bonuses in the case of a merger or acquisition still occur, and that disclosure to shareholders is lacking.[8] Any form of incentive payment that significantly skews the incentives of management or directors differently from those of shareholders should be at least a candidate for increased disclosure and a separate vote on the annual proxy.

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[5] Financial Stabiity Forum, op. cit.

[6] Financial Services Authority, "Reforming remuneration practices in financial services: Feedback on CP09/10 and final rules," August 2009.

[7] Hartzell, Jay, Eli Ofek and David Yermack, "What's In It For Me? CEOs Whose Firms Are Acquired," posted at http://pages.stern.nyu.edu/~eofek/Parachutes.pdf, August 2002.

[8] Securities and Exchange Commission, Plaintiff, Against Bank of America Corporation, Defendant, posted at http://www.sec.gov/litigation/complaints/2009/comp21164.pdf, August 3, 2009

Missing links: items with no connection to performance. Also, there are certain items in executive compensation whose link to performance is unclear. An egregious example is the use of tax gross-ups, in which shareholders compensate executives for taxes they pay, often on perquisites. The Corporate Library (TCL) pointed out that in the 2006/7 proxy season, one-fifth of the nearly 3,300 companies it covered paid part of their CEOs' income tax bills, in some cases for perquisites that have dubious or no connection to performance in their own right. To make matters worse, in over one-third of the cases in which shareholders were obliged to pay for executives' taxes on the value of their perquisites, the report of the compensation committee did not even specify what the payments were for.[9] In other cases, tax gross-ups were paid for spousal travel, club dues, tax preparation, gifts, health, boating, and in one case, a PS3 entertainment system. It is difficult to understand how this form of executive compensation contributes to shareholder value. Allowing shareholders to vote on executive pay is a step in the right direction, but an additional step, requiring a separate vote on the perquisites whose connection to performance is not clear, would be even stronger. At a minimum, the SEC should consider requiring compensation committees to describe clearly the connection of each perquisite to performance in their Compensation Discussion & Analysis.

How investors use say on pay

Investors use the results of advisory votes on executive compensation and any related action (or inaction) from directors as an indicator of the board's loyalty and responsiveness to shareholders. A compensation package that is strongly opposed by shareholders, as indicated by a high number of votes against, should result in some action or response from the board, including an acknowledgement of shareholder concerns and a commitment to address them. Likewise, the lack of a response or action by the board in the event of a high opposition vote could raise serious concerns among shareholders.

Poor executive compensation practices can be an indication of other looming problems as well. A board that is too beholden to management may make decisions that benefit management insiders to the detriment of shareholders and may encourage excessive risk-taking and a short-term focus to the detriment of long-term, sustainable corporate performance. An advisory vote on compensation allows shareholders the opportunity to weigh in on compensation practices and encourage them to be righted before they contribute to larger problems.

There is recent evidence that this is true from the United Kingdom, which passed legislation requiring companies to provide shareholders with the opportunity to cast nonbinding annual votes on executive compensation in 2002. According to a 2009 Harvard Business School paper by Ferri and Maber[10] examining the effects of Say on Pay in the UK, there is a documented increase in boards' sensitivity to poor performance that is "more pronounced in firms with high voting dissent, but [that] extends more generally to firms with excess CEO pay, regardless of the voting dissent, suggesting that some firms responded to the threat of a negative vote by acting ahead of the annual meeting. Evidence on explicit changes in CEO pay contracts made in response to specific shareholder requests confirms a shift toward greater sensitivity of CEO pay to poor performance."

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[9] Hodgson, Paul, "2008 Proxy Season Foresights #7: Tax Reimbursement: The Grossest Perk," The Corporate Library, March 31, 2008.

[10] Ferri, Fabrizzio and David Maber, "Say on Pay Votes and CEO Compensation: Evidence from the UK," Harvard Business School, Posted to the Social Science Research Network June 16, 2009.

Specifically, the authors found that, among the 30 UK firms with the highest dissenting vote on Say on Pay in the first year during which it was in effect (2003), a significant number "removed or modified provisions that investors viewed as 'rewards for failure' (e.g., generous severance contracts, low performance hurdles and provisions allowing the retesting of performance conditions)…We also find evidence of similar actions taken in 2002 (*before* the vote) in a sample [of] 30 firms experiencing low voting dissent, suggesting that the threat of a vote was effective in inducing firms to revise CEO pay practices ahead of the annual meeting." In short, the reality of having to face an annual shareholder vote—even an advisory one—appears to have had a proactive effect on reining in some of the more egregious practices in executive pay. Ferri and Maber also found that the UK's say on pay vote requirement also improved communications with shareholders. The authors point out that "a number of firms established a formal process for proactive consultation with their major shareholders going forward. As a result of these actions, firms were able to substantially reduce voting dissent at the next annual meeting."

Investors Want a Say on Pay

There is broad investor support for an advisory vote on compensation. An initiative to encourage companies to obtain annual approval of executive compensation, or the "say on pay" initiative, led by the American Federation of State, County and Municipal Employees (AFSCME) and other institutional investors, has been gathering steam for several years. There were more than 100 say on pay shareholder proposals filed last year, [11] but according to Paul Hodgson, an expert on executive compensation at TCL, only nine companies among the 3,200 covered by TCL subjected their executive compensation plans to shareholder approval at the beginning of 2009.[12] The failure by companies to respond to growing shareholder sentiment in favor of a shareholder advisory vote on compensation is, in our view, a compelling reason why the Commission itself should consider taking action at this time.

We appreciate the support in Congress and the Obama administration for advisory votes on compensation for companies receiving assistance from the TARP, but of course these are companies that have already experienced significant meltdowns, due in part to misaligned incentives that encourage excessive risk taking and short-term thinking. We believe that a standing requirement for all companies to allow investors to vote on executive compensation may help companies and investors avoid some of the these problems in the future - before rather than after meltdowns occur – because shareholders will have the opportunity to send appropriate signals to directors and management about inappropriate or otherwise problematic compensation schemes

We applaud the SEC for proposing rules that would increase shareholder rights and promote director accountability to shareholders. We certainly support the proposed rule requiring TARP recipients to provide a shareholder advisory vote to approve the compensation of executives as disclosed in the Compensation Discussion & Analysis. However, we think it's very important to take the additional step of extending the advisory vote on executive compensation requirement to *all* publicly traded companies. We also believe that the SEC should consider strengthening its proposal to require separate votes on incentive pay factors that may misalign incentives of management with

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[11] *Annette Nazareth, "'Say on Pay' Now A Reality for TARP Participants," Harvard Law School Corporate Governance Forum, http://blogs.law.harvard.edu/corpgov/2009/02/27/%E2%80%9Csay-on-pay%E2%80%9D-now-a-reality-for-tarp-participants/, Feb. 27, 2009.*

[12] *Personal Communication with Paul Hodgson, March 25, 2008.*

those of shareholders, and to require a separate vote on perquisites and other factors in executive compensation that have little or no relationship to performance.

Sincerely,

Joseph F. Keefe
President & CEO
Pax World Management Corp.