Council of Institutional Investors
The Voice of Corporate Governance

Via Email

October 14, 2010

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

Re: File Number S7-14-10 (Concept Release on the U.S. Proxy System)

Dear Ms. Murphy:

The Council of Institutional Investors (Council) is a non-profit association of public, corporate and union pension funds with combined assets in excess of $3 trillion. Member funds have a duty to protect the retirement assets of millions of American workers.

The Council welcomes the re-examination of the mechanics of proxy voting by the Securities and Exchange Commission (SEC), as outlined by the Concept Release on the U.S. Proxy System, Release No. 34-62495, File Number S7-14-10. We appreciate the opportunity to offer our comments, which follow below in the order of their presentation in the release.

III. B. Vote Confirmation

The recent growth in contested issues in shareowner meetings has drawn greater attention to an issue that has long been a concern of companies and shareowners alike: the ability to confirm the accuracy of votes. Earlier this year, the Council adopted a Statement on Principles for an Effective and Efficient Proxy Voting System. Two key points from that statement are that votes properly cast should be correctly tallied, and secondly, that a proxy voting system should provide for end-to-end confirmation enabling both companies and shareowners to confirm that votes properly cast were included in the final tally as directed.[1]

The Council understands that the complexity of the current voting chain presents special challenges for confirmation from an operational perspective. These challenges should not take precedence over ensuring the fundamental integrity of our proxy voting system. We believe the current framework, and particularly its dependency on voluntary information sharing, strengthens the argument for adopting means to assure that votes are tallied correctly.

The Council supports further exploration of the advantages and disadvantages of creating unique identifiers for each beneficial owner, which could establish an audit trail

[1]Council of Institutional Investors Statement on the Principles for Proxy Voting are available at: http://cii.org/UserFiles/file/Statement%20on%20Principles%20for%20Proxy%20Voting.pdf

through which beneficial owners and companies could automatically confirm vote accuracy.

III. C. Proxy Voting by Institutional Securities Lenders

Members of the Council, like many other institutional investors, take advantage of securities lending to reduce custodial fees and provide supplemental income to their portfolios.[2] Voting rights ascribed to loaned shares generally transfer to the borrower. If the lender wishes to cast a vote for a particular meeting, the lender must terminate the loan and recall the shares before the meeting's record date.

We believe the SEC should adopt regulatory reform that allows shareowners to make better informed decisions regarding whether to recall loaned shares. As established in the Council's Corporate Governance Policies, such an approach should include two key principles: (1) shareowner meeting record dates should be disclosed as far in advance as possible, and (2) proxy statements should be disclosed before the record date passes whenever possible.[3]

III. D. Proxy Distribution Fees

The Council recognizes the critical importance of having an efficient, reliable, and accurate system for proxy distribution. We acknowledge that the existing framework provides predictability and that centralization has yielded some benefits, particularly with respect to a centralized electronic voting platform for institutional investors. A departure from the current framework may require an examination of possible ways to preserve existing predictability and efficiencies.

We do not believe that a high quality system requires self-regulatory organizations (SROs) to maintain the responsibility for setting distribution fees. To facilitate reasonable costs for proxy distribution services,[4] market forces should determine such rates, and the client of the services, whether a company or a shareowner group, should determine which distributor to employ. We support a non-discriminatory market for proxy distribution services in which the client's status as a company or a shareowner group has no impact on the price paid for those services.

A market-based approach to the pricing of distribution fees will only serve its intended purpose of reducing costs and increasing efficiency if multiple service providers are able to compete in the market. The transition to a market-based system could lead to unintended consequences if implemented abruptly. The continued use of SRO-determined distribution fees may be necessary throughout a transitional period during

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[2] The Council released a primer in 2006 on share lending, a copy of which is available at: http://www.cii.org/UserFiles/file/resource%20center/publications/Securities%20Lending%20Primer.pdf .

[3] The Council's Corporate Governance Policies are available at: http://cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2009-29-10%20FINAL.pdf . See Section 4.3, at p. 9.

[4] The Council's Statement on the Principles for Proxy Voting states: "The cost of distributing proxy materials and votes should be reasonable."

which the SEC considers tools that may enhance market competition, such as the creation of a central data aggregator to gather and disseminate beneficial owner information.

IV. A. Issuer Communication with Shareholders

Although the Council has a policy addressing interaction between companies and shareowners[5], we have not adopted a policy regarding the current system of objecting beneficial owners and non-objecting beneficial owners (OBO/NOBO). However, the Council commissioned an independent study, released in February 2010, to investigate the OBO/NOBO distinction and its implications.[6]

The study observes that "…the immediate interest of shareowners and companies in better communications would be better and more effectively served with an incremental approach that supports less reliance on – or eliminates altogether – the OBO/NOBO distinction and otherwise increases the potential for direct communications."

The study identifies two steps to promote greater transparency around shareowner lists and opportunities for direct communications by shareowners and companies:

1) Eliminate the OBO/NOBO distinction "through a phased implementation starting with a mandate to make NOBO the default status for customer accounts, with full disclosure about the consequence of selecting by the study would involve making NOBO the default status and charging a fee to shareowners who wish to maintain anonymity via OBO status. Even after the OBO/NOBO distinction is eliminated, customers could maintain their anonymity through nominee accounts."

2) Relax restrictions on the ability of companies and shareowners to distribute proxy materials and solicit proxies directly, and streamline the process for both companies and shareowners to obtain shareowner lists.

We note the study's comments regarding the role of intermediaries in a post-OBO/NOBO environment:

> "Even in a world where direct communications are fully permissible, we believe that companies will continue to use agents for purposes of compiling shareowner lists and particularly document distribution given the advantages of large scale fulfillment in terms of cost and reliability."

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[5] The Council's corporate governance policies are available at: http://cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2009-29-10%20FINAL.pdf . See Section 2.6b, at p. 4.

[6] The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting, by Alan L. Beller and Janet L. Fisher, available at: http://www.cii.org/UserFiles/file/CII%20White%20Paper%20-%20The%20OBO-NOBO%20Distinction%20in%20Beneficial%20Ownership%20February%202010.pdf . All quotations refer to Section VIII, at p. 20.

"…preserving a 'neutral' agent as the centralized repository of shareowner lists may also provide comfort to shareowners who, we understand, find the current system for requesting shareowner lists from Broadridge (or another agent) to be relatively easy and inexpensive."

IV. B. Means to Facilitate Retail Investor Participation

The Council recognizes that there is no panacea for the problem of low retail investor participation. Increased retail voting is likely to involve multiple initiatives, which may include investor education campaigns, enhancements to brokers' online platforms, and reforms to "Notice and Access" rules.

The Council does not have an official policy with respect to client-directed voting, but we commissioned a study, released in August 2010, to explore the concept. [7] We note the following findings of that study:

- "…no iteration of client-directed voting persuasively addresses the core problem, which is one of investor education – convincing retail beneficial owners of the importance of their vote."

- "Under any client-directed voting model, retail beneficial owners would set voting instructions before disclosure about the matters in question is available and before the specific matters are known … This is in stark contrast to the core objective of the current proxy framework that does not permit voting in the absence of highly detailed disclosures because of the high value the SEC places on making sure investors have the opportunity to understand the matters on which they are asked to vote."

- "The complexity of client directed voting and the policy and regulatory issues it entails suggest to us that a robust client-directed voting model is likely to have a long gestation period. This is particularly the case since any client-directed voting model must be considered in light of the wide range of proxy infrastructure questions that the SEC is now raising. Many of these questions involve regulatory changes that may be more expeditious and, possibly more effective tools to increase retail beneficial owner participation."

The Council views the recent elimination of discretionary voting by brokers as a major step forward for the integrity of our proxy system.[8] This milestone ended a policy that

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[7] Client Directed Voting: Selected Issues and Design Perspectives, by Alan L. Beller, Janet L. Fisher, and Rebecca M. Tabb is available at: http://www.cii.org/UserFiles/file/resource%20center/publications/CII%20White%20Paper%20-%20Client%20Directed%20Voting%20August%202010.pdf. All quotations refer to Section VI, at p. 21.

[8] The Council's Corporate Governance Policies are available at: http://cii.org/UserFiles/file/CII%20Corp%20Gov%20Policies%20Full%20and%20Current%2009-29-10%20FINAL.pdf . See Section 3.7, at p. 8.

caused millions of shares to be voted without regard for their owners' preferences. In this context, we are concerned that a rigid form of client-directed voting, in which shareowners must choose among always voting with management, always voting against management, always abstaining, or always voting in accordance with a third-party, may not be able to fully capture shareowners' preferences.

A robust system of client-directed voting would be nimble enough to accommodate the nuances of a shareowner's true preferences, allow for the revocation of advance instructions, and involve periodic reaffirmation of advance instructions.

IV. C. Data Tagging Proxy-Related Materials

The Council supports the use of standardized data-tagging for proxy –related materials and voting results as a means of increasing transparency and expanding shareowners' ability to track governance practices, compare practices among peers, make informed voting decisions, and follow the results of shareowner meetings. Data-tagging would also facilitate companies' ability to keep abreast of their peers' governance practices, and may result in a reduction in errors in proxy advisers' reports for shareowner meetings.

The implementation of data-tagging for proxy-related materials and voting results would require careful attention to how the data is used by investors. A thoughtfully developed data-tagging system will minimize the likelihood of "apple-to-orange" comparisons by investors.

V.A. Proxy Advisory Firms

Ever since the Department of Labor's 1988 "Avon Letter," which asserted that proxy voting rights are plan assets subject to the same fiduciary standards as other plan assets, pension fund managers have been on high alert to vote their proxies in the best interest of beneficiaries. Proxy advisory firms play an important role in helping pension fund managers fulfill their fiduciary duties with respect to proxy voting by providing an analysis of issues on the ballot, executing votes and maintaining voting records. Without proxy advisers, many pension plans—particularly smaller funds with limited resources—would have difficulty managing their highly seasonal proxy voting responsibilities for the thousands of companies in their portfolios.

Some observers contend that proxy advisory firms' recommendations have too much influence on the outcome of voting at U.S. public companies. The Council disputes this view. An examination of some recent tallies suggests that proxy advisers' clout is greatly exaggerated. According to Institutional Shareholder Services' (ISS) Voting Analytics search tool, ISS issued a baseline recommendation of "against" for 28 out of 136 management-sponsored say-on-pay proposals in 2010. Only three of the 28

proposals actually failed to pass, and the average shareowner support of those 28 proposals was 74 percent.[9]

Data on director elections further illustrates proxy advisory firms' limited influence. Of 15,044 ISS baseline recommendations for nominees in 2010, 13 percent were "withhold" or "against." Of the 1,879 nominees receiving "withhold" or "against" baseline recommendations with available voting results, less than 5 percent failed to receive majority support from shareowners. The average shareowner support for nominees with a "withhold" or "against" baseline recommendation from ISS was 77 percent.[10]

The notion that proxy advisory firms "control the institutional vote" wrongly assumes that institutions are a unified bloc of voters. In fact, many institutional investors are passive voters that defer routinely to the recommendations of management. We note that state and local pension funds, whose ranks include many of the most activist investors, hold just 6 percent of total outstanding equity.[11]

Institutional investors' use of proxy advisers' services, whether research or vote execution, does not equate to the "outsourcing" of voting decisions. We stress that proxy advisers' clients retain the ability to vote however they wish, and regularly diverge from their proxy advisers' recommendations through customized voting guidelines or case-by-case review. We believe many clients of proxy advisers use firms' research and recommendations solely as a supplement to their own evaluation of agenda items.

From an empirical standpoint, we note that nine of the Council's 10 largest member funds (which collectively have more than $900 billion of assets under management) do not delegate their voting decisions to a proxy adviser. These nine pension funds, like many other institutional investors, use their own guidelines, which are updated continually or on an annual basis, to govern their voting decisions.

The overlap between institutional investors' guidelines and proxy advisers' policies does not prove that advisers drive institutions' positions on voting issues. Overlap may reflect advisers' efforts to be in synch with their clients. Proxy advisory firms survey their clients' views on voting issues regularly, and it is not unusual for advisers to adjust their guidelines on a particular issue to prevailing preferences.

While the Council does not have a formal policy on proxy advisory firms, we acknowledge the importance of their role in providing pension funds with informative and accurate information about matters that are put before shareowners for a vote. It is reasonable to expect proxy advisory firms to provide clients with substantive rationales for vote recommendations; minimize conflicts of interest and disclose the details of such conflicts; and correct material errors promptly and notify affected clients as soon as practicable. The Council supports the registration of proxy advisory firms, but opposes

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[9] Source: ISS Voting Analytics for Russell 3,000 annual meetings between Jan. 1, 2010 and Sept. 15, 2010.
[10] Id.
[11] The Conference Board's 2009 Institutional Investment Report, at p. 25.

regulatory involvement in methodologies used by proxy advisers to determine vote recommendations.

Conclusion

The Council appreciates the SEC's bold undertaking to comprehensively review the U.S. proxy system, and is grateful for the opportunity to comment on the many issues related to it. We trust that the Commission's thorough examination and subsequent rule-making will result in a stronger, more efficient system for both shareowners and the companies in which they invest.

Sincerely,

Glenn Davis
Senior Research Associate
Council of Institutional Investors