Via Email

January 14, 2010

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

Re: Facilitating Director Nominations (File Number S7-10-09)

Dear Ms. Murphy:

I am writing on behalf of the Council of Institutional Investors ("Council"), an association of public, corporate, and union pension funds with combined assets of over $3 trillion. As a leading voice for long-term investors, the Council welcomes the opportunity to provide comments on additional data and related analyses submitted at or after the close of the initial comment period for the Securities and Exchange Commission's ("SEC" or "Commission") proposed rule *Facilitating Shareholder Director Nominations* ("Proposed Rule").

As we fully describe in our original comment letter, the Council strongly supports the Proposed Rule.[1] We wholeheartedly agree with the Commission that there is an urgent need to amend the proxy rules to better facilitate the exercise of shareowners' fundamental rights to nominate and elect directors. Nearly seventy years have passed since the Commission first considered whether shareowners should be able to include director candidates in management's proxy materials. This reform, which has been studied and considered on and off for decades, is long overdue. Its adoption would be one of the most significant and important investor reforms put in place by any regulatory body in decades—a desperately needed boost to investor confidence.

The financial crisis highlighted a longstanding concern—some directors are simply not doing the jobs expected by their employers, the shareowners. Compounding the problem is that in too many cases the director nomination process is flawed, largely due to limitations imposed by companies and the securities laws. Council members' sense is that companies rarely give serious consideration to shareowner-suggested director candidates. Shareowners can now only ensure that their candidates get full consideration by launching an expensive and complicated proxy fight—an unworkable alternative for most investors, particularly fiduciaries who must determine whether the very significant costs of a proxy contest are in the best interests of plan participants and beneficiaries.

Despite the compelling case for proxy access outlined by the Commission in its initial proposal, some of the rule's opponents favoring so-called "private ordering" continue to argue that any federal proxy access rule would be both unnecessary and dangerous. Still others argue that a federal rule with an investor "opt-out" provision is sufficient. Both of these views are severely misguided. When the fog of various myths about proxy access and "private ordering" is dispelled, it becomes clear that only a uniform, federal proxy access rule can truly remedy the deeply flawed director election process and empower investors to hold boards accountable. As the SEC reviews this second round of public comments, we urge the Commission to reject the following myths about its proposed proxy access rule.

[1] Our original comment letter is available online at http://www.sec.gov/comments/s7-10-09/s71009-78.pdf.

MYTH: Recent changes to state law make a federal proxy access rule unnecessary.

Some proxy access opponents have argued that a federal rule is unnecessary given recent changes to Delaware corporate law allowing companies or investors to adopt proxy access bylaws. From a practical standpoint, leaving proxy access to Delaware and other states could result in a hodge-podge of standards that would differ from company to company and from state to state. This would be burdensome, costly and unnecessarily complex for investors, particularly those like Council members with diversified portfolios of thousands of companies incorporated in multiple states. Further, the 500-word limit for shareowner proposals severely constrains an investors' ability to draft and discuss a proxy access bylaw. Finally, as a November 2009 white paper commissioned by the Council and ShareOwners.org describes, many companies have supermajority voting requirements to amend the bylaws making shareowner-proposed proxy access bylaw amendments nearly impossible to implement.[2]

MYTH: Proxy access will subsidize investors leading to excessive nominations.

Opponents of the Commission's proxy access proposal rest such predictions on a completely backwards picture of the economics of director elections. Through use of corporate funds, investors currently subsidize 100 percent of the election costs for board endorsed candidates, yet they bear the costs of a proxy contest completely on their own. According to an estimate by the California Public Employees' Retirement System, these costs can easily reach $5 million or more.[3] This deeply skewed framework harms all investors by discouraging shareowners from undertaking value enhancing steps to hold management and boards accountable.

Proxy access would help level the playing field by reducing the prohibitive costs of shareowner nominations. Though some modest increase in contested elections may occur, the most likely result is a significant expansion of company engagement with investors. With shareowner nominations a viable option, proxy access will give directors greater incentive to come to the table. This has precisely been the experience of international markets with similar investor nomination procedures where active dialogue rather than election contests is the norm.

The robust ownership and holding requirements included in the proposed rule further guard against excessive nominations by limiting eligibility to a large, long term investor or group of investors. Contrary to the claims of proxy access opponents, the proposed rule's ownership thresholds are by no means easy to meet given that the largest institutional investors—mutual funds—rarely if ever sponsor shareowner resolutions, even those they support. The institutional investors most likely to make use of proxy access, largely public and union pension funds, currently hold a relatively small interest in most public companies due to their highly diversified portfolios. For example, the California State Teachers' Retirement System, one of the largest public pension funds in the nation, generally owns only about 0.3 percent of the outstanding stock of any company in the Russell 3000.[4]

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[2] The Corporate Library. "The Limits of Private Ordering: Restrictions on Shareholders' Ability to Initiate Governance Change and Distortions of the Shareholder Voting Process" (November 2009). Available at http://www.cii.org/UserFiles/file/The%20Limits%20of%20Private%20Ordering%20UPDATED%2011-17-09.pdf.

[3] Letter from Joseph A. Dear, Chief Investment Officer, California Public Employees' Retirement System, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, at 3 (August 14, 2009). Available at http://www.sec.gov/comments/s7-10-09/s71009-259.pdf.

[4] Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Nancy M. Morris, Secretary, Securities and Exchange, at 3 (September 18, 2007). Available at http://www.sec.gov/comments/s7-16-07/s71607-200.pdf.

Ownership data supports the SEC's proposed tiered eligibility criteria as a sound balance. Our recent examination of the holdings of the ten largest public pension funds in a sample of five accelerated filers and five non-accelerated filers indicates that if the ten largest holders were to aggregate shares, they would not be able to meet a five percent threshold and would be unlikely to meet even a three percent threshold. By comparison, an examination of the ten largest public pension funds' holdings in a sample of fifteen large accelerated filers indicates that a one percent threshold could be met if the ten largest holders were to aggregate their shares.[5]

MYTH: Proxy access will facilitate the election of "special interest" directors.

Fears that proxy access could facilitate the election of "special interest" directors that do not share the interests of long term investors are overblown. While the Council agrees with the SEC and many others that there should be reasonable restrictions on shareowner eligibility, the proposed rule's tiered ownership and one year holding requirements combined will effectively prevent abuse and ensure that nominating shareowners are large, long term investors. As discussed above, these criteria are by no means easy to satisfy. Moreover, all shareowner nominees ultimately have to win the approval of investors. A duly nominated and elected director under the Commission's proposed proxy access rule is one who presumably reflects the views and interest of most shareowners; otherwise he or she would not have been elected.

MYTH: A federal rule providing for a shareowner opt-out is an "investor choice" approach to proxy access.

Like the shareowner proposal rule (Rule 14a-8), proxy access at its core is a disclosure matter most appropriately handled by the SEC, which since its creation has been responsible for setting uniform proxy statement disclosure standards. An opt-out in this context would be a radical departure from 75 years of investor protection that ultimately would be harmful to the investing public. If the Commission decides that information regarding anticipated director nominations should be disclosed in the proxy in order to allow shareowners to make an informed voting decision, then such information should be disclosed by all companies. This uniform approach is consistent with the SEC's longstanding goal of structuring the proxy process to replicate the annual meeting. An opt-out mechanism is furthermore fundamentally inconsistent with the notion that a minimum level of access to the proxy is needed to level the electoral playing field and give substance to investors' fundamental right to nominate directors.

In our view, a rule that provides for a proxy access opt-out is hardly an "investor choice" model, but rather a "management choice" model that permits public companies to continue to deny their shareowners the fundamental right to nominate and elect directors. A shareowner vote on a management endorsed proposal to opt out of proxy access would hardly express the genuine will of investors. Since management proposals are considered "routine" under New York Stock Exchange Rule 452, brokers would be eligible to vote uninstructed shares held in "street name." Broker votes are almost always cast in favor of management's recommendation, significantly tilting the scales in favor of an opt-out proposal. Such a skewed vote is particularly dangerous given that companies most in need of corporate governance improvements are those most likely to opt-out of a proxy access rule. Finally, even if individual companies were to adopt a proxy access by-law, the ownership threshold may be set so high that proxy access could rarely, if ever, be exercised by long-term institutional investors.

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[5] Michael McCauley, Tracy Stewart, and Jacob Williams of the Florida State Board of Administration assisted the Council staff in this research. The source data for the research was compiled from a FactSet Research Systems, Inc. database of Schedule 13F filings.

Given the truth about proxy access and the significant flaws of a so-called "private ordering" approach, it is clear that only a uniform federal rule providing a minimum level of access to the proxy will achieve the SEC's goal of removing impediments to shareowner director nominations. The Council believes the Commission's proposed rule provides reasonable access to corporate proxy materials for long-term shareowners and would thus address some of the problems surrounding director elections. As has been our longstanding position, we believe such access would significantly enhance the U.S. corporate governance model and contribute to the health and long-term value of U.S. public companies by making boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant in their oversight responsibilities.

The Council appreciates the renewed opportunity to comment and we urge the Commission to promptly finalize the proposed rule. If you have any questions about our views, please do not hesitate to contact me at (202) 261-7096 or jonathan@cii.org, or our general counsel Jeff Mahoney at (202) 261-7081 or jeff@cii.org.

Sincerely,

Jonathan D. Urick

Jonathan D. Urick
Analyst
Council of Institutional Investors