October 19, 2010

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

Re: ***Comment Release on the US Proxy System*** **(S7-14-10)**

Dear Ms. Murphy:

The American Federation of State, County and Municipal Employees ("AFSCME"), is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan (the "Plan") is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME. As a result, AFSCME takes a strong interest in the integrity, transparency and reliability of the proxy voting and shareholder communication processes.

We write to respond to the Commission's request for comment on its concept release (the "Concept Release") on the U.S. proxy system. In general, we support the Commission's exploration of ways to improve the functioning of the shareholder voting and communication processes. Because funds in which AFSCME members are participants not only vote proxies but also seek at times to communicate with other shareholders, it is critically important to us that any reforms not reduce the amount of information available to shareholders or impair shareholders' ability to communicate with one another around issues of common concern.

Proxy Distribution and Shareholder Communications

The Concept Release describes the current system of proxy distribution, which involves beneficial owner anonymity (at least vis-à-vis issuers), multiple intermediaries and significant complexity. The Concept Release reports

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discontent, particularly on the part of issuers, with the difficulty and expense entailed in communicating with beneficial owners. In particular, Broadridge, the dominant (near-monopoly) provider of proxy distribution services, is characterized as charging fees that may exceed the "reasonable rates" for which reimbursement is allowed.

In our view, regulatory oversight of Broadridge has been less than robust. The Concept Release outlines recommendations made by the New York Stock Exchange's Proxy Working Group ("PWG") in 2006 that have yet to be implemented. For example, the PWG recommended that an independent third party study Broadridge's performance and analyze the fees it charges. That review has not taken place. Similarly, the PWG recommended that the NYSE continue to study the feasibility of fostering a more competitive market for proxy distribution services. We know of no such study having been done.

Some commentators appear to believe that proxy system performance would improve and fees would be lower if competition were fostered in the proxy distribution arena. Without more data, including the data that would be produced through the PWG's initiatives discussed above, it is not possible to draw those conclusions with any certainty. Smaller companies might have fewer economies of scale and be forced to charge more to provide the same services. Smaller companies might also have inferior technology or fewer resources with which to audit performance. Fragmentation could cause overall performance of the system to suffer.

Whichever direction the Commission takes on this issue, it is imperative that the system accommodate communications between beneficial owners as well as communications from issuers to beneficial owners. Any changes to provide greater access to shareholder lists should be devised in a way to ensure equal access to both issuers and beneficial owners. Proxy solicitation vendors should not be able to compete for companies' business by refusing to distribute communications sent by shareholders or by charging shareholders more than issuers for distribution of similar communications. Nor should issuers be permitted to use control over beneficial owner data in a way that creates barriers to dissemination of information. The Commission's 1992 revisions to the proxy rules reflected a view that communication among shareholders is valuable, a view shared by us and the funds in which our members participate. Encouraging competition without ensuring shareholder access would represent a step backward.

Proxy Advisory Services

The Concept Release relates a perspective on the role of proxy advisory services—that they "control" shareholder voting, exert that control without appropriate oversight, suffer from undisclosed conflicts of interest and avoid accountability for recommendations based on inaccurate information. This description mischaracterizes the role of proxy advisors, understates the diversity in voting patterns and ignores the market-based pressures on proxy advisory firms.

Proxy advisory firms serve an important function, especially for extremely diversified investors such as many of the funds in which our members participate, of assembling company-specific research, analyzing ballot items and recommending how clients should vote on those ballot items. Contrary to the impression given in the Concept Release, proxy advisory firms do not have a single set of guidelines they use to produce a single set of recommendations. Instead, many clients hire proxy advisors to apply the clients' guidelines. Thus, it is not accurate to speak of a single proxy advisory firm governance approach dominating shareholder voting.

Having conducted shareholder initiatives, we know that advisory firms' recommendations are considered carefully by their clients, but are not always followed. Institutional investors with which we have communicated indicated that they review the reasoning provided for the recommendation, collect input internally and then make the voting decision.

Research we have conducted regarding mutual fund voting patterns on compensation issues supports the notion that proxy advisors do not control voting outcomes. For the past several years, AFSCME, The Corporate Library and Shareowners.org have analyzed reported votes of mutual funds on management and shareholder proposals on executive pay, as well as the election of selected directors at companies with controversial or excessive executive pay practices.

We found a great deal of difference in voting patterns, even among fund families we understand to be clients of the same proxy advisory firm. For example, Fidelity funds supported 57% of management proposals on executive compensation, while Barclays supported 96% of such proposals. On shareholder proposals, the disparity was even more dramatic: Legg Mason voted in favor of 97% of proposals in the categories selected for the study and Vanguard voted in favor of only 3%. Such a high degree of variance dispels any notion that clients follow proxy advisors' recommendations in lockstep. Our previous two studies are available at: http://www.afscme.org/docs/AFSCME-2009-Report_Compensation-Complicity.pdf and http://www.afscme.org/docs/mutual_Fund_full_report.pdf.

Institutional Shareholder Services ("ISS") data show that its recommendations tend not to be outcome-determinative. ISS recommended that clients vote against 28 of 136 management say on pay proposals in 2010; shareholders failed to approve only three proposals. Although ISS recommended that clients vote against or withhold support from 13 percent of director nominees in 2010, fewer than five percent were not supported by holders of a majority of shares voted.

We support the full disclosure of conflicts of interest on the part of proxy advisory firms and it is our understanding that the funds in which our members are participants inquire into the existence of conflicts and procedures for managing them when they engage proxy advisory firms. The Concept Release suggests, however, that market participants may not be aware of the full range of relationships the Commission would consider to be conflicts under the Investment Advisers Act. Therefore, we believe it would be useful for the Commission to produce interpretive guidance on that question.

We are not convinced that proxy advisory firms' recommendations are often tainted by factual inaccuracies. The example cited in the Concept Release, the ISS recommendation at Target's 2009 annual meeting (where a dissident short slate was being run by hedge fund Pershing Square), seems to be somewhat inapposite. Two of the eight points raised in Target's "white paper"—the characterization of Target's real estate ownership as "atypical" and the calculation of compound annual growth rate—are arguably factual in nature. One involved the out-of-context use of a quotation. The other five, though, are characterizations, interpretations or conclusions with which Target disagreed: "RiskMetrics wrongly paints Target as resistant to change," "RiskMetrics questions Target's strategy" and "The RiskMetrics report lacks any critical analysis of Pershing Square's nominees," for example.

Proxy advisory firms' agreements with their clients, we understand, typically tend to be for one or two years. This fact, combined with the existence of several proxy advisory firms with comprehensive coverage, allows shareholders who are unhappy with their proxy advisory firms' performance to change firms. The availability of market forces, as well as the difficulty of regulating what is a somewhat subjective evaluative process, militate against the Commission attempting to regulate the substance of proxy advisors' work.

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We appreciate the opportunity to express our views on this matter.

Sincerely,

Gerald W. McEntee

GERALD W. McENTEE
International President