

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

20 October 2010

Dear Ms Murphy:

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

We are writing in response to the request for comment from the SEC its Release No. 34-62495, File Number S7-14-10, relating to the reforms currently under consideration which would affect the U.S. proxy system.

By way of background, Hermes Fund Managers Limited is owned by the British Telecom Pension Scheme, the UK's largest. Hermes manages the portfolios of over 200 other clients including many major pension schemes. Hermes Equity Ownership Services (EOS) also advises non-investment clients on governance and corporate engagement matters in respect of about US\$65 billion of equities. These clients include Ireland's National Pensions Reserve Fund, Australia's VicSuper, Lothian Pension Fund, Pensioenfonds PNO Media, and PKA, one of Denmark's largest occupational pension funds. Among the work we carry out for our clients we actively vote their proxies in markets around the world which includes significant voting in the U.S.

We are extremely supportive of the Securities and Exchange Commission's efforts to enhance the current U.S. proxy voting system and assert that the current conditions evidence the timeliness and need for the type of reforms presented in the SEC's Release

Given that we broadly support the SEC's effort at a policy level, we have only a few comments on specific key points, outlined below.

**Commentary on the Release**

*(For ease of reference we have adopted the numbering system used in the Release.)*

**Section III**

**III.B. Vote confirmation**

Hermes EOS believes that the current proxy voting system provides very little clarity to investors wishing to confirm their votes have been cast in the correct manner. Efforts to reconcile voting instructions via proxy advisory firms or custodians are cumbersome and ineffective. Often the beneficial owners receive vote rejections after the meeting date and without a sufficient rationale as to why the vote has been rejected. Custodians or sub custodians often are unable or unwilling to shed further light onto this process. As a result investors lack a sufficient mechanism which allows them to verify that voting instructions have been submitted and cast in the intended manner.



Based on Hermes EOS's experience processing almost all of our clients' votes via web based platforms we are led to believe that these votes have been submitted in time to the relevant issuer. However, there is no way for us to verify this in a reliable fashion. Often we find ourselves having to vote ballots on multiple occasions and yet still we are not sure that these votes have been counted.

We believe the best way to ensure that ballots can be confirmed as having passed through the chain and received successfully would be to use a ballot control number that can be tracked throughout the voting chain. It is likely that this responsibility should be placed at the custodian level and would enable investors to better audit and verify their voting activity. We would encourage the creation of a unique identifier on a ballot level rather than on a beneficial owner level. We feel that this approach would be advantageous as each ballot could be audited separately and if one ballot fails to reach a company meeting in time the repercussions for the rest of the ballots for the same investor are limited to a degree.

We feel that as a basic element of this process issuers should confirm to all beneficial owners that a vote has been received, in what way the vote has been cast, and how many shares have been voted. They should pass this information back on to the custodian, proxy voting agencies or directly on to the owner of the shares if known to the company. This procedure would create an auditable voting trail and would enable the person who cast the vote to double check if the vote has been cast in the correct way.

Proxy voting participants should have the ability to test the effectiveness of such controls to ensure that the relevant procedures are effective. The results should clarify if a party in the voting chain is delaying the proxy voting process and the relevant party (proxy agency, registrar, and custodian) should then be accountable to the beneficial owner. Additionally we would support the creation of a grievance mechanism where the various parties in the voting chain can escalate issues appropriately.

## **Section IV**

### **IV.A. Issuer Communications with Shareholders**

We believe the NOBO/OBO system of classification for beneficial owners of securities adds unnecessary complexity and cost, and strongly support its abolition. This system impedes effective and cost-efficient communication between issuers and investors and represents a barrier to achieving a more transparent, accurate, and reliable proxy voting system.

We agree with the opinions detailed in the Release which assert that changes in corporate governance practices, such as a move to majority voting for the election of directors and the elimination of broker discretionary voting in uncontested director elections, has increased the need for issuers to communicate directly with beneficial owners. It is clear that, for a more efficient proxy system to be achieved, communication between issuers and beneficial owners must be facilitated through a more transparent system of identifying beneficial owners. In this sense, we support proposals by various groups, including the Business Roundtable and the Shareholder Communications Coalition, to bypass securities intermediaries and their agents when forwarding proxy materials as part of simplifying the voting and tabulation process. We strongly believe that a reduction in the participation of intermediaries in the proxy voting process will benefit issuers and beneficial owners alike.

We do not believe quorum requirements are of central relevance in this discussion. While most state corporate law, including that of Delaware, set the default quorum at 50% of outstanding shares, in practice, this is rarely the case as most companies' bylaws establish a much lower threshold for quorums at shareholder meetings. We believe the benefits of increased shareholder participation extend far beyond achieving quorum.

#### **IV.B. Means to Facilitate Retail Investor Participation**

Hermes EOS strongly supports investor education programs that expressly seek to increase shareholder participation at annual and extraordinary general meetings. We believe that the use of electronic technology is the most effective solution to simplifying the proxy voting process for retail investors and removing process impediments. We believe that permitting retail investors to access and analyze proxy materials, as well as cast votes, without having to revert to a third party would greatly improve the ability of retail investors to participate in the voting process.

#### **IV.C. Data Tagging Proxy-Related Materials**

Hermes EOS believes that the use of technology to increase the quality and quantity of information available to investors can only be beneficial to the proxy voting process. The ability to access, process, and analyse increased amounts of information will enable investors to cast a more informed vote at shareholder meetings and render the process of determining voting decisions more efficient.

### **Section V**

#### **V.A. Proxy Advisory Firms**

Hermes EOS's view is that proxy advisory firms provide a valuable service to institutional investors across the globe who have come to rely on their research, data, analyses and voting recommendations as an important tool to aid in the implementation of their voting policies. Overall we feel that proxy advisory firms benefit not only the investor community by facilitating more informed voting decisions but also issuers whose proxy materials might not otherwise receive the appropriate levels of attention.

While we are supportive of proxy advisory firms as useful service providers which help investors reach more considered voting decisions through the research and insight they offer, Hermes EOS feels that the investor is ultimately responsible for votes cast in the investor's name. While we acknowledge the concerns of certain critics who assert that proxy advisors exert undue influence by "controlling" large blocks of votes as a result of institutional investors' passive acceptance of the voting recommendations they provide, we know of no verifiable evidence which supports such claims. Regardless of the degree to which such claims can be verified, we feel strongly that ultimate accountability for voting decisions rests firmly with investors rather than the proxy advisory firms.

While the final responsibility for voting decisions should be placed on investors, we agree with the concerns of the Commission about potential conflicts of interest which may arise when proxy advisory firms provide services to issuers or have a significant interest in an issuer. We find the current system of "fire walls" and vague disclosure presently employed by advisory firms to be insufficient. We support the Commission's consideration of regulations aimed at addressing this issue by requiring increased transparency of proxy advisory firms to eliminate or reduce conflicts of interest by establishing detailed disclosure requirements relating to their fees, client relationships, conflicts and research procedures.

As such we would welcome additional information about the Commission's proposals: (1) requiring proxy advisory firms to register as investment advisers; and (2) regulating proxy advisory firms in a manner similar to credit rating agencies (NRSROs).

While we are supportive of the Commission's desire to address the potential conflicts of interest which proxy advisory firms currently confront, we do not feel that strict regulatory controls or rules governing the accuracy of proxy advisory firms' research data would be effective in achieving this aim. As such we would encourage the Commission to place its emphasis on addressing the underlying structural relationships which cause these potential disconnects.

## **V.B. Dual Record Dates**

Hermes EOS supports the use of separate “notice” and “voting” record dates, as outlined in the Release, as a means of providing a practical solution to the problems that currently arise from the long time period between record and meeting dates. As part of this we are supportive of the Commission eliminating from its rules and regulations current time requirements that would conflict with the proposed system of dual record dates.

To the extent it is logistically feasible, we are firmly of the belief that the interests of shareholders would be best served by setting voting record dates as close to the meeting date as possible in order to ensure that voting rights are exercised by investors who own stock on the meeting date.

We continue to support the current practice of providing early notice record dates, as it retains the benefit of extra time for the distribution of proxy materials and informed voting by shareholders.

We feel that issuers should continue to be required to distribute printed proxy materials to shareholders who buy stock after the record date up to 10 calendar days before the meeting. The burden of accessing the notice, agenda and related proxy materials electronically from the issuer’s web site and arranging to vote either electronically, by proxy or in person should be borne by those shareholders who purchase shares fewer than 10 calendar days before the meeting date.

We see no reason that would prevent the implementation of appropriate technologies which make possible the reconciliation of share records on an ongoing basis, up to the meeting date, thereby permitting an accurate voting record date to be set much closer to the meeting date.

As noted earlier, the elimination of the NOBO/OBO system would reduce many of the logistical problems of record-keeping, distribution of proxy materials and vote tabulation described in this section of the Release.

We have one further comment on record dates: We believe that the record dates for voting and for dividends should be clearly separated. This will help eliminate one of the demands for stock borrowing around the voting record date, and in so doing, reduce the risk of decoupling discussed below.

## **V.C. “Empty Voting” and Related “Decoupling” Issues**

Hermes EOS shares many of the Commission’s concerns about the disconnect of voting rights from economic interests through “empty voting,” “decoupling,” “buying votes” and related phenomenon. We fully subscribe to the position conveyed in the Release which outlines the threats to the integrity of share voting and the entire corporate governance system posed by the “significant decoupling of voting rights from economic interest (that) could potentially undermine investor confidence in the public capital markets.”

We feel that a crucial step in addressing this fundamental issue is the adoption of new rules which would require enhanced transparency of economic interests and eliminate empty voting. As such we support the Commission’s consideration of such measures.

In addition to the benefits outlined in Section V.B of our response above, we feel that the creation of rules which would permit voting record dates to be set closer to meeting dates would also serve to help eliminate some of the existing conditions which presently contribute to empty voting and decoupling practices.

We encourage the Commission to further investigate the prevalence and root causes of the conditions that give rise to empty voting and decoupling and welcome further consultation on this topic.

## Conclusion

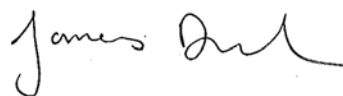
We fully endorse the Securities and Exchange Commission's review of the U.S. proxy system which we feel represents an opportunity to address several problematic issues which have persisted for a number of years. We are encouraged by the potential reforms presented in the Release which we feel will have a positive impact on in the U.S. as well as other markets globally. We are hopeful that these changes will lead to a more harmonized global proxy system by providing a much needed update to the current U.S. structure and solidify the integrity of share voting and the entire corporate governance system. In closing, we are pleased to lend our feedback to the SEC with respect to this Release which represents an important step towards the achievement of these worthwhile ambitions.

Please do not hesitate to contact us should you have further questions. We would be delighted to discuss these issues with you further.

Respectfully yours,



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Manager, Americas



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