



October 20, 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:

As the nation's leading membership organization for independent directors, NACD has an important perspective on the proxy system. A nonprofit educational organization established in 1977, we convene, educate, and inform our 10,000+ members and other corporate stakeholders in an effort to advance exemplary board leadership.

In a speech given at this year's NACD Corporate Governance Conference, SEC Chairman Mary Schapiro acknowledged the value of past dialogue with NACD, and invited more comment from NACD and its individual members. Past NACD letters to the SEC have addressed a variety of topics including internal controls, nominating committee practices, enhanced proxy disclosures, and proxy access. In all of these letters, we have emphasized the importance of transparency and independence.

We are grateful for the opportunity to comment on the SEC's Concept Release on the U.S. Proxy System, issued July 14, 2010. (<http://www.sec.gov/rules/concept/2010/34-62495.pdf>.) The Concept Release specifically asks for comments on various aspects of three general areas:

- Accuracy, transparency, and efficiency of the voting process (including a request for comments on anonymity of share ownership)
- Communication and shareholder participation (including a request for comments on company communications with beneficial owners)
- Relationship between voting power and economic interest (including a request for comments on the role of proxy advisory firms)

For simplicity, we have combined the first two categories, as our comments center around two primary issues: shareholder communications and the role of proxy advisory firms.

Accuracy, Transparency, and Efficiency of the Voting Process, and Communication and Shareholder Participation

NACD shares with the SEC the goal of promoting direct communication between companies and their investors. In order to promote such communications, the SEC adopted a rule a quarter century ago (Rule 14a-13(b)(5) under the Securities Exchange Act of 1934) to require broker-dealers and banks to provide companies, at their request, with lists of the names and addresses of street name holders (beneficial owners) who did not object to having such information provided to issuers. These owners are called non-objecting beneficial owners, or “NOBOs.” When beneficial owners object to disclosure of their names and addresses to the company, these objecting beneficial owners, or “OBOs,” may be contacted only by the securities intermediary serving the owner.

This sounds good in theory, but this rule has had unintended consequences. Under the current OBO/NOBO rule, according to one estimate cited in the Concept Release, up to 80% of all public issuers’ shares are held in street name, and 75% of those shares, or up to 60% of all shares, are held by OBOs. In many cases, brokers have used OBOs as a default. Shareholders are not always aware that they are considered to be “objecting,” or what the consequences to communication would be.

In 2005, NACD joined with the National Investor Relations Institute and the Business Roundtable to request that the SEC review the OBO/NOBO rule to make it easier for companies to communicate with their beneficial owners. The following year (June 2006), the New York Stock Exchange’s (NYSE) Proxy Working Group made a similar request. We are encouraged by the current review of the OBO/NOBO rule.

The Concept Release asks for comment on “*whether we should eliminate the OBO/NOBO distinction, thereby making all beneficial owner information available to the issuer, or require broker-dealers to disclose the consequences of choosing OBO or NOBO status, or whether OBO or NOBO status should be the default choice.*”

Companies should be able to communicate directly with shareholders and the current OBO/NOBO rule, as implemented, makes this difficult. NACD is aware that some beneficial owners would strongly object to elimination of the OBO/NOBO distinction. If the SEC decides to keep the distinction for this or other reasons, we believe that brokers will need to do a better job of explaining the rule and its consequences to beneficial owners. All investors should be made aware of the importance of voting in today's corporate governance environment. At the very least, we recommend that NOBO be the default standard, and that all current OBOs be given the opportunity to become NOBOs, should they so choose.

Relationship between Voting Power and Economic Interest

Today over half of equities are owned by institutional shareholders—many of them holding shares in a wide variety of companies. How they vote their shares has a major impact. Therefore, it is important for institutions to be well informed about the companies in which they invest.

Over the past two decades a number of advisory firms have begun to do one or more of the following:

- advise proxy voting
- advise companies on governance/sell governance products and services
- vote shares on behalf of owners
- rate board governance privately
- rate board governance publicly

There is nothing wrong with any of these functions. The problem lies in certain combinations.

- First, and most obviously, firms that advise proxy voting or cast votes on behalf of owners could have a conflict of interest when advising companies on their governance practices.
- Second, when a firm that advises proxy voting also rates governance publicly, this gives the firm a relatively high degree of power to force governance changes in companies, even if the companies have good reasons to govern themselves in another manner.

In this part of the Concept Release, the Commission asks questions in 19 areas. It is beyond the scope of this letter to answer all these questions. Instead, we will focus on one of these areas: *Do proxy advisory firms control or significantly influence shareholder voting without appropriate oversight? If so, is there empirical evidence that demonstrates this control or significant influence? If such proxy advisory firms do control or significantly influence shareholder voting, is that inappropriate, and if so, should the Commission take action to address it? If so, what specific action should the Commission take?*

- Yes, we believe proxy advisory firms can significantly influence shareholder voting. We have anecdotal evidence that our members have altered their governance policies and practices to influence ratings and recommendations from the advisory firms.
- We do not believe that, for the most part, proxy advisory firms need additional regulation. However, if companies vote shares on behalf of owners, they should register as investment advisors.

NACD recommends more transparency and independence: Companies should be able to understand the standards by which they are being judged, and advisors should be free from any conflicts of interest. Companies that have separate businesses to advise shareholder voting and to advise company governance should be required to separate the two businesses. This would be similar to the terms stated under Section 501 of the Sarbanes-Oxley Act that required the SEC to pass rules (or request the stock exchanges to pass rules) “to establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision.” (See Regulation Analyst Certification <http://www.sec.gov/rules/final/33-8193.htm>.)

Conclusion

The proxy voting system is a means to an end. The goal of the system is the accurate voting of shares in a transparent and informed manner in a process free of conflicts of interest.

The Commission has identified other issues, including over-voting and under-voting (caused by imbalances in broker votes, securities lending, and failure to deliver), disclosure of voting by funds, proxy distribution fees, low retail investor participation in proxy voting, dual record dates, “empty voting,” and related “decoupling” issues. We believe that many of these problems can be solved by improvements in technology. New technologies and social media are changing the way boards garner information and sentiment from shareholders. Companies can do more to use technology in board-shareholder communications.

Our members strive to ensure the long-term economic health of the corporations they serve. In the spirit of an informed dialogue between the public and private sector, we hope you will consider the two concerns we have raised—namely, the need to change the OBO/NOBO default to NOBO, and the need to ensure proxy advisor transparency and independence.

Sincerely,

Hon. Barbara H. Franklin
Chairman
NACD

Kenneth Daly
President and CEO
NACD