



Setting the global standard for investment professionals

22 November 2010

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

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

Dear Ms. Murphy:

CFA Institute¹ is pleased to comment on the *Concept Release on the U.S. Proxy System* (the “Concept Release”) issued by the Securities and Exchange Commission (the “SEC” or the “Commission”). CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency and integrity of global financial markets.

Executive Summary

CFA Institute appreciates the SEC’s consideration of revisions to the proxy process to promote greater efficiency and transparency. We have long believed that shareowner votes are an important way for shareowners to protect their economic interests in the companies they own. It is imperative, therefore, that this process be transparent and protect the integrity of shareowner votes. To be fully effective, the process also should seek to promote shareowner participation and support more direct and meaningful communications between issuers and shareowners.

In this regard, we support to a large extent, the Commission’s proposals to improve the accuracy and transparency of the voting process, the manner in which shareowners and corporations communicate, and efforts to increase retail investor participation. We also strongly endorse the tagging of relevant proxy data and qualitative information.

While we do not believe there is a serious breakdown in the relationship between voting power and economic interest, we do support increased transparency about the use of proxy advisory firms. At the same time, we do not support steps to restrict the ability of investors to hedge their economic risks and interests as unwarranted given the limited amount of empty voting that

¹ CFA Institute is a global, not-for-profit professional association of over 105,000 investment analysts, advisers, portfolio managers, and other investment professionals in 137 countries, of whom more than 93,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories.



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occurs in U.S. markets. Finally, we would not support further restrictions on the ability of investors to lend their shares.

Comments on Specific Proposals

III. Accuracy, Transparency, and Efficiency of the Voting Process

A. Over-Voting and Under-Voting

CFA Institute has long believed that the proxy voting system is fundamental to the integrity of our capital markets. We are concerned, therefore, that over-voting or under-voting may occur in the proxy process, but are encouraged that the SEC is identifying a number of issues that both issuers and investors should work to remedy.

Whenever a voting decision is close, it is imperative that no over-voting or under-voting has occurred regardless of whether the vote concerns a merger, election of directors where a majority vote is required, or shareowner advisory vote regarding executive compensation. We believe the Commission should work with all parties in the proxy process to significantly reduce the possibility that close votes result in outcomes not supported by the actual votes of shareowners.

We also encourage the Commission to work with relevant parties to consider ways to ensure that the final tally reflects actual shareowner voting. To this end, we support requiring broker-dealers to disclose their allocation and reconciliation processes to help address these concerns.

B. Vote Confirmation

CFA Institute supports the Commission's suggestion of asking all participants in the voting chain to grant access to their share-voting records to issuers' transfer agents and vote tabulators, for the limited purpose of enabling confirmation of shareowner votes. Each of these agents should confirm to registered owners, beneficial owners, or securities intermediaries that they have received and properly tabulated their votes.

While we are unsure about how much such confirmation would cost issuers and their agents, it is hard to imagine that such a technology cost would prohibit the development of a system in which votes can be accurately confirmed. Nevertheless, we do not believe that the cost would exceed the intangible cost resulting from a lack of trust in the voting system for shareowners.

C. Proxy Voting by Institutional Security Lenders

CFA Institute believes that institutional investors in the United States might benefit if issuers were required to publicly disclose their annual meeting agendas sufficiently in advance of the



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record date. In particular, this would permit those who have lent their securities to determine whether they wish to recall any share loans in order that they can vote their proxies.

With regard to advancing the transparency of securities lending practices, CFA Institute believes that investment firms should require customers to acknowledge in writing at the outset of a relationship and periodically thereafter that they have received and understood information that the investment firms may lend their clients' shares to others. Without such acknowledgement, shareowners may discover at the time of the annual general meeting that their shares were lent to another investor and that they cannot vote those shares. Confirmation and transparency, on the other hand, should be sufficient to give intermediaries approval to lend the investors' securities.

3. Disclosure of Voting by Funds

We are unsure how much benefit investors would receive from increased Form N-PX disclosure of the aggregate number of shares voted and not voted by their investment firms. Disclosing the number of shares voted each way in Form N-PX is unlikely to convey relevant information about the factors behind deciding whether to vote or lend the shares.

We take some comfort in the fact that these firms have a fiduciary duty to act in the best interests of their clients. While we are not convinced that this is an issue that would benefit from the proposed disclosure at this time, we urge the Commission to closely monitor investor complaints about matters related to voting and to take steps to ensure that firms' voting activities are done in a manner that serve the best interests of their clients.

IV. Communications and Shareholder Participation

A. Issuer Communication with Shareholders

CFA Institute believes the SEC should revisit the current OBO/NOBO (objecting beneficial owners/non-objecting beneficial owners) landscape and develop a system in which it is easier for issuers to communicate with shareowners. This should include educational efforts to help beneficial owners better understand the current OBO/NOBO system and what this means to them. One possible means of doing this would be to recognize NOBO as the default status for future new accounts, with beneficial owners able to opt in favor of OBO status. In any event, brokers should more clearly highlight and disclose a shareowner's OBO/NOBO position when a customer enters into a brokerage agreement.

We would also encourage consideration of whether the OBO mechanism has outlived its useful purpose in this electronic age. There may be a means of allowing issuers to have full transparency while preserving complete confidentiality for owners, both in receiving information and prohibiting consultants or other outside parties from having access to such owner information.



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B. Means to Facilitate Retail Investor Participation

CFA Institute believes that giving individual investors the ability to access proxy materials and voting instruction form (VIF) information through a client's account page on a broker's Web site might be useful in generating more retail investor involvement. We understand that some organizations, including proxy advisory organizations, are considering a move in this direction as a means of assisting their clients. We believe the SEC should encourage the use of such technology to better educate investors and to provide better access to the proxy process with the goal of getting them more involved in voting.

We would support the Commission's consideration of creating a reasonably priced means of providing retail investors with access to proxy research, vote recommendations, and vote execution (see section below on "Data Tagging Proxy-Related Materials"). Likewise, advance voting instructions, much like those used by institutional investors, may be one way to increase voter participation, although controls must be used to guard against abuse. And investors should be allowed to, and perhaps required to, revisit these decisions on a periodic basis.

We encourage some of the investor-to-investor communications suggested in the *Concept Release*. And we support use of plain English in all communications between issuers and investors, and encourage the SEC to promote those efforts.

C. Data-Tagging Proxy-Related Materials

In order to increase transparency and to give investors greater access to proxy-related information, we encourage the Commission to allow, and for issuers to provide, data-tagging in issuer documents such as the proxy statement through the use of a standard tagging format, such as XBRL (eXtensible Business Reporting Language). Permitting interactive proxy data formats should enhance the information needs of investors and enable them to easily engage in the type of research envisioned in the immediately preceding section of this letter. Tags could do this by targeting information on share ownership, director experience, related-party transactions, executive compensation data, compensation strategies (by tagging standardized section headings), audit fee numbers, and a host of other useful information currently found in the corporate proxy.

V. Relationship between Voting Power and Economic Interest

A. Proxy Advisory Firms

Many issuers have expressed concern in recent years about the perceived power that proxy advisory firms hold over the proxy process. The primary concern is that investors, and



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especially institutional investors who hold a greater concentration of shares than any other group, may be swayed by these entities' suggestions.

Our experience and interaction with these investment institutions tells us that this concern is exaggerated. Nevertheless, there may be steps that institutional investors and others who vote proxies on behalf of those investors can develop to assure beneficiaries and issuers that proxies are voted in a reasoned and conscientious manner. To provide such assurance, we believe these investor institutions and firms need to develop policies to ensure that shareowner votes are handled properly, namely by:

- Developing guidelines for initial reviews of new or controversial proxy issues;
- Ensuring that proxy-voting decisions agree with the investment interests, objectives, and preferences of the investor, participants, or beneficiaries of an account;
- Creating a mechanism to review unusual proxy proposals;
- Having a process for deciding whether to communicate with a company's management or board of directors prior to, or following, a vote;
- Having a process for determining whether to join the proxy efforts of other concerned investors in taking specific actions with regard to a company;
- Having a process for determining when and how to report the proxy positions taken during the proxy season; and
- Having a process to identify and vote proxy issues by particular accounts considering the specific preferences of beneficiaries, participants, or other clients.

Such policies will help both shareowners and their advisers to not only vote the proxies, but to do so in a manner that is consistent with clients' interests. Moreover, such policies will enable individual clients to focus on whether the investment firm's policies are acceptable to them.

Concerns about conflicts of interest among proxy advisory firms who may provide more than one service to their clients should be addressed through thorough and timely disclosures to all proxy advisory firm clients. In our view proxy advisory firms currently provide a sufficient level of information to both clients and others regarding their recommendations on proxy issues, including compensation plans. Consequently, we do not believe that proxy advisory firms should be required to publicly disclose their decision models for approval of executive compensation plans, for example, as some groups have suggested.

B. Dual Record Date

Some states are adopting procedures that enable issuers to set record dates for determining which shareowners are entitled to notice of upcoming meetings that are separate from the record dates to determine which are entitled to vote at those meetings. The State of Delaware, for example, now allows this. These changes enable a company to set a voting record date close to the meeting date in an effort to increase the likelihood that those entitled to vote as of the meeting date will also continue to hold an economic interest in the issuer.



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We have mixed views about these developments based on how similar structures function in overseas markets. For example, we are told that vote buying is less prevalent in the United States than in Europe because, in part, U.S. investors are less likely to borrow shares at the record date weeks or months in advance of the meeting. This is largely because they won't know whether particular agenda items might become controversial or lead to close votes that far in advance.

By comparison, we are told vote buying is more prevalent in those European markets that permit companies to set record dates just prior to shareholder meetings. Under such systems, investors who are interested in specific agenda items are able to better gauge whether those items will produce close or controversial votes, and borrow shares shortly before the meeting if they believe they can influence the outcome of the votes.

We also are told that reducing the amount of time between the record and meeting dates might create other problems for investors and issuers alike. In particular, the proximity of record and meeting dates could increase the difficulty for institutional investors to vote their shares and have certainty that their votes are accurately counted.

Based on these concerns, together with a recognition that share-lending firms have increased disclosure of their lending programs in recent years, we recommend that the Commission first see how popular the dual-record date provision is and how they play out in jurisdictions where they are being implemented before launching any federal regulatory response.

C. Empty Voting

CFA Institute supports the ability of investors to maximize the return on their assets. Those assets include not only the shares but also the proxy votes attached to the ownership of those equity positions.

Concerns have been raised about the ability of an investor to lend its voting interest away or to otherwise hedge the underlying economic risks associated with the equity asset and still use the proxy asset by voting the shares. This so called "empty" voting is criticized as an improper separation of the equity asset and proxy asset, such that the proxy asset should have restricted validity apart from the underlying equity interest.

We disagree strongly with this view. We believe it would inappropriately limit investors' ability to hedge economic risks and to maximize asset returns. We also believe such restrictions would impair investors' legitimate voting rights. Record ownership determines voting rights. Attempts to qualify such rights via some test of "at risk" economic exposure to the underlying equity is contrary to fundamental corporate governance protections.

Concluding Comments

CFA Institute is pleased to submit its views on the Commission's *Concept Release on the U.S. Proxy System*. If you or your staff have questions or seek clarification of our views, please feel



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free to contact either Kurt Schacht, CFA, at +1.212.756.7728 or kurt.schacht@cfainstitute.org, or James C. Allen, CFA, at +1.434.951.5558 or james.allen@cfainstitute.org.

Sincerely,

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