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Concept Release on the U.S. Proxy System
Release No. 34-62495

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

Dear Ms. Murphy:

We are writing to comment on the concept release published by the U.S. Securities and Exchange Commission (the "Commission" or the "SEC") on July 14, 2010, entitled *Concept Release on the U.S. Proxy System* (the "concept release"). International Business Machines Corporation ("IBM" or the "Company") welcomes the opportunity to share its views on some of the important matters raised by the concept release. We applaud the Commission for considering these numerous complex issues that affect issuers and shareholders. IBM previously shared its views on several of the items raised by the SEC in this concept release when we submitted a comment letter on the SEC's proxy access proposal.[1] Fixing these problems will ensure a better voting system, allow for greater communications between an issuer and its shareholders, and generate more accurate voting processes. We continue to believe that the Commission should have addressed these significant "proxy plumbing" issues before issuing final proxy access rules; we note that there is currently a stay of effect of these rules.[2]

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[1] *See* IBM's August 12, 2009 comment letter to SEC Release No. 33-9046, "Facilitating Shareholder Director Nominations," June 18, 2009, 74 Fed. Reg. 29,025, *available at* http://sec.gov/comments/s7-10-09/s71009-108.pdf.

[2] Order Granting Stay of Effect of Commission's Facilitating Shareholder Director Nominations Rules, October 4, 2010, *available at* http://www.sec.gov/rules/other/2010/33-9149.pdf.

I. **Proxy Advisory Firms must be Subject to Greater Regulation.**

As noted by the SEC, over the last twenty-five years, institutional investors have "substantially increased their use of proxy advisory firms."[3] This has resulted in shareholder votes that have become increasingly affected by the power of these firms that, in many instances, exert significantly more influence on the outcome of votes than an issuer's largest shareholder. Despite the evidence of their influence over the election of directors and other votes at U.S. public companies, the proxy advisory industry remains largely unregulated. The SEC must take action now so that these firms are subject to the necessary checks and safeguards to ensure that companies and their shareholders are adequately protected.

A. Proxy advisory firms exert too much control over shareholder voting decisions.

It is important as an initial step to recognize the significant influence that proxy advisory firms have over corporate matters. As of December 31, 2009, one such firm, Institutional Shareholder Services ("ISS") (formerly known as RiskMetrics Group) had approximately 3,500 clients, including 70 of the 100 largest investment managers, 43 of the 50 largest mutual fund companies, and 42 of the 50 largest hedge funds (in each case measured by assets under management).[4] ISS provides corporate governance and specialized financial research and analysis services to approximately 2,970 clients.[5] The SEC notes that as of June 2007, ISS's client base was more than the four other major firms in the industry combined.[6]

To be clear, the troubling part is not the sheer number of clients that ISS, for example, has, but rather the significant influence it exerts over the millions of votes cast each year by its clients. This influence is felt by companies in all industries almost immediately upon release of the ISS report on the company's proxy statement. To illustrate, within one business day after ISS releases its report on a particular company, a significant number of shares held by institutions are voted in a lock-step manner (i.e., 100% in accordance) with the ISS recommendation. We submit that this phenomenon is evidence of *de facto* control by ISS of these votes and of how institutional holders outsource their voting decisions to ISS.

Below is a chart that shows a cross-section of Fortune 500 companies in different industries in the 2009 and 2010 proxy seasons, with each company receiving more

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[3] SEC Release No. 34-62495, "Concept Release on the U.S. Proxy System," July 14, 2010, 75 Fed. Reg. 42982, *available at* http://sec.gov/rules/concept/2010/34-62495fr.pdf (hereinafter referred to as the "Release" or "concept release").

[4] RiskMetrics Group. Inc., Annual Report on Form 10-K for the fiscal year ended December 31, 2009, *available at* http://www.sec.gov/Archives/edgar/data/1295172/000104746910001246/a2196648z10-k.htm (hereinafter referred to as "ISS 2009 Form 10-K").

[5] Id.

[6] Release, 75 Fed. Reg. at 43,011, n. 271.

than 10% of its total votes cast lock-step with ISS's recommendations within one business day after the ISS report was released.[7]

Company	Votes Cast Lock-Step Within One Business Day after ISS Recommendations as an Approximate Percent of Total Votes Cast
2009	
Company A	17.8%
Company B	15.7%
IBM	13.5%
Company C	12.9%
Company D	12.4%
Company E	11.9%
Company F	11.6%
2010	
Company G	12.9%
Company H	12.7%
IBM	11.9%
Company I	11.5%
Company J	10.9%

Note: We believe that ISS's influence is far greater than what is shown in the "one business day" amounts in the table above; however, that additional influence is difficult to quantify because institutional investors are not required to publicly disclose when they in essence "outsource" decision making over proxy matters to third parties.

For IBM, an estimated 13.5% and 11.9% of the total votes cast in each year were cast lock-step with ISS's recommendations within one business day after the release of ISS's report on IBM in 2009 and 2010, respectively. By comparison, for the previous five business days, no more than 0.20% and 0.27% of the total IBM votes were cast in any one day in 2009 and 2010, respectively. **To put that into proper perspective, the IBM voting block essentially controlled by ISS has more influence on the voting results than IBM's largest shareholder. And this voting block is controlled by a proxy advisory firm that has no economic stake in the company and has not made meaningful public disclosures about its voting power, conflicts of interest or controls.**

This influence directly and significantly affects the election of directors. For example, in 2006, ISS recommended a "withhold" vote against one of IBM's directors because a family member of the director was employed by IBM in a non-officer capacity. That year, 22.59% of the votes cast were withheld for this director. In 2007, ISS flipped its voting recommendation on this director, and he instead received a "for" recommendation from ISS; as a result, that year this director received only an 8.78% "withhold" vote. The

[7] Data provided by one of the Company's proxy service providers.

underlying facts had not changed nor had the make-up of IBM's institutional shareholders changed significantly. This nearly 14% swing in the vote outcome is clearly attributable to ISS's changed recommendation and is consistent with the information above regarding ISS exercising control over IBM's votes cast.

B. The SEC should adopt regulations providing for more oversight of and public disclosure by proxy advisory firms.

1. The SEC should prohibit certain conflicts of interest and require disclosure of other significant conflicts.

As discussed by the SEC in the concept release, many advisory firms meet the definition of an investment adviser and are therefore subject to the Investment Advisers Act.[8] The SEC also notes in the concept release that the Supreme Court has construed Section 206 of the Investment Advisers Act as Congress' recognition of the fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose all conflicts of interest.[9] As SEC Commissioner Kathleen Casey has noted, "proxy advisory firms often face conflicts of interests arising from providing corporate governance advisory services to registrants and providing voting recommendations to their institutional investor clients, and have been reported on occasion to make voting recommendations based on inaccurate analyses of registrant corporate governance or other data."[10] As discussed in more detail below, one example of these conflicts relates to corporate governance scores. Firms like ISS provide governance ratings to issuers based on ISS's perceptions of the issuers' corporate governance practices, but also provide consulting advice to the same issuers on how to improve the score. Commentators have raised concerns about whether this allows companies to influence ISS's ratings if they are willing to pay for it.[11]

This concern about proxy advisory firms having significant conflicts is exacerbated by inadequate disclosure in their voting recommendation reports about conflicts. Institutions relying on these advisory firms' advice should be made aware of such conflicts. Without any disclosure to the contrary, institutions presumably assume that the firms are free of conflicts with regard to recommendations they make about issuers. The SEC notes in the concept release that certain proxy advisory firms include boilerplate disclosure in their voting recommendation reports that they "may" have a consulting relationship with the issuer.[12]

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[8] Release, 75 Fed. Reg. at 43,010.

[9] Release, 75 Fed. Reg. at 43,010, n. 249.

[10] Kathleen L. Casey, Commissioner, U.S. Securities and Exchange Commission, Statement at SEC Open Meeting, July 1, 2009, *available at* http://sec.gov/news/speech/2009/spch070109klc.htm.

[11] *See* Paul Rose, *The Corporate Governance Industry*, 32 Iowa J. Corp. L. 887, 903 (2007), citing Troy Wolverton, A Warning About eBay's Options 'Giveaway,' TheStreet.com, June 16, 2003, *available at* http://www.thestreet.com/stocks/troywolverton/10093761.html.

[12] Release, 75 Fed. Reg. at 43,012.

This "disclosure" is clearly inadequate because it provides no specific or meaningful information to the institutional investor about any current or former relationship the firm has with the issuer. By not adequately disclosing their specific conflicts of interest, these proxy advisory firms are likely violating their fiduciary duty to deal fairly with their clients.[13]

a. Proxy advisory firms should be subject to similar oversight by the SEC as Nationally Recognized Statistical Rating Organizations.

We believe that because of the significant role and influence of proxy advisory firms, they should be subject to oversight similar to that of nationally recognized statistical rating organizations (i.e. credit rating agencies). Investors rely on these credit ratings as part of their investment decisions and therefore need to know whether there are any conflicts in order to properly assess the validity of the specific ratings. Similarly, given the level of influence if not outright control that advisory firms have, comparable requirements must be imposed on these firms. In fact, similar regulations are even more imperative with regard to proxy advisory firms because there is a single dominant proxy advisory firm – in contrast, there are at least three significant credit rating agencies.

In terms of oversight, rating agencies are required to establish, maintain and enforce written policies and procedures to address and manage conflicts of interest.[14] Furthermore, because some activities necessarily result in a conflict, they are prohibited outright by rule. For instance, rating agencies are prohibited from issuing or maintaining a credit rating for an issuer in which the rating agency made recommendations about the corporate or legal structure, assets, liabilities, or activities of such issuer.[15] Other prohibited activities include stock ownership of an issuer by a credit analyst who participates in the determination of a credit rating.[16]

Clearly, similar rules should be adopted to prohibit proxy advisory firms from providing consulting services to companies for which they make voting recommendations or issue governance scores. As noted by the SEC, there is an inherent conflict where an issuer utilizes the consulting services of an advisory firm where such services are used to improve governance scores.[17] Necessarily, such scores will be skewed and not be a proper comparison against companies that do not utilize such advisory firms for consulting services. These examples are the most commonly referenced conflicts of interest for proxy advisory firms as noted by the GAO report cited in the concept release.[18] In short, proxy advisory firms should

[13] *See* Release, 75 Fed. Reg. at 43,013.

[14] 17 CFR 240.17g-5(a)(2).

[15] 17 CFR 240.17g-5(c)(5).

[16] 17 CFR 240.17g-5(c)(2).

[17] Release, 75 Fed. Reg. at 43,012.

[18] Release, 75 Fed. Reg. at 43,011-12, n. 275.

be prohibited by rule from providing consulting services to an issuer about which it makes voting recommendations. These prohibitions are important because as also noted in the GAO report, the firm might recommend a vote in favor of a client's shareholder proposal in order to keep the client's business, which would threaten the integrity of the vote.[19]

Additionally, ISS's most recently filed Form ADV discloses that it buys or sells securities of issuers that it also recommends to advisory clients.[20] ISS also disclosed that it recommends securities to advisory clients in which it has other ownership interests.[21] Similar to the existing rating agency rules, these types of activities should be prohibited for proxy advisory firms. Further, employees of proxy advisory firms who work on vote recommendations or governance scores of a particular company should be prohibited from owning or trading in the stock of that company.

b. The SEC should require additional disclosure of proxy advisory firms' Form ADVs.

We applaud the recent changes that the SEC adopted to Form ADV, including requiring increased narrative disclosure of conflicts of interest and the processes in place to manage those conflicts.[22] This will provide more meaningful disclosure to investors. We believe the SEC should consider making further changes consistent with providing vital information to investors. As explained in more detail below, this should include a requirement that any institutional investor who subscribes to a proxy advisory firm must disclose this in its Form ADV. Further, the institution should be required to post the advisory firm's Form ADV on its website so that interested stakeholders of the institutional investor would be adequately notified of any potential conflicts.

2. The SEC should require disclosure of beneficial ownership by proxy advisory firms.

Given the level of *de facto* control over voting exercised by proxy advisory firms such as ISS, the SEC should conclude that these advisors are beneficial owners of the shares in question. "Beneficial owner" is defined in Rule 13d-3 under the Securities Exchange Act of 1934 as having sole or *shared* voting and/or dispositive power over the shares in question.[23] The aforementioned evidence of lock-step voting shows that proxy

[19] Release, 75 Fed. Reg. at 43,012.

[20] ISS Governance Services, Inc., Form ADV, dated March 31, 2010, *available at* http://www.adviserinfo.sec.gov/%28S%28jhz3g255jzxzzo55qfaieu45%29%29/IAPD/Content/ViewForm/ADV/Sections/iapd_ADVIdentifyingInfoSection.aspx.

[21] Id.

[22] Investment Advisers Act Release No. IA-3060 (July 28, 2010), *available at* http://www.sec.gov/rules/final/2010/ia-3060.pdf.

[23] 17 CFR 240.13d-3.

advisory firms "share" voting power with certain of their clients. Therefore, the advisory firm should be required to disclose its beneficial ownership in any company in which it shares voting power of more than 5% of a class of registered equity securities.

3. The SEC should require disclosure of proxy advisory firms' proxy governance models.

Proxy advisory firms should also be required to disclose, at least annually, their proxy governance models, including the guidelines, processes and assumptions they make, as well as the methodologies and sources of information supporting their recommendations. Further, any proxy advisory firm that adopts a one-size-fits-all approach on any significant issue should be required to disclose its rationale for the belief that every single company, regardless of its particular facts and circumstances, should have the same policy. As the SEC notes, a one-size-fits-all approach is troubling because it will result in a policy that would benefit some issuers but is less suitable for other issuers and would therefore result in a voting recommendation that is not appropriate for many issuers in all situations.[24]

Concurrently, proxy advisory firms should be required to publish all of this information in a prominent location on their website and update the information periodically. This information would allow the thousands of proxy advisory firm clients to properly assess the bases for these firms' recommendations and, more importantly, enable these institutions to make more informed decisions about whether the firms' procedures yield recommendations that are in the best economic interests of their holders.

C. The SEC should reexamine proxy advisory firms' exemption from the proxy solicitation rules.

1. Background.

The SEC should also reexamine the exemption from the proxy solicitation rules given to proxy advisory firms. In 1979, the SEC adopted Exchange Act Rule 14a-2(b)(3), which exempted proxy advisory firms from the requirement to publicly furnish their proxy voting advice so long as certain requirements were met. The exemption was adopted well before the proxy advisory industry experienced substantial growth in size and influence. In fact, ISS was not founded until six years *after* the exemption was in place.[25] Other major proxy advisory firms have been established only in the past few years, including Glass, Lewis & Co., LLC, which was founded in 2003 and PROXY Governance, Inc., which began providing proxy advisory services in 2005.[26] Because the influence of these firms has grown

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[24] Release. 75 Fed. Reg. at 43,012.

[25] *See* ISS 2009 Form 10-K.

[26] *See* About Glass Lewis, *available at* http://www.glasslewis.com/company/; *See* PROXY Governance History, *available at* https://www.proxygovernance.com/content/pgi/content/history.shtml.

significantly since the exemption was first promulgated, it is time for the SEC to reexamine the exemption.

For instance, the exemption does not require that proxy advisory firms adopt specific procedures to ensure that their research or analysis is materially accurate or complete prior to recommending a vote. Additionally, when proxy advisory firms provide voting services, they are not required to verify that all votes are cast correctly. To retain the benefit of this exemption, proxy advisory firms should be required to adopt written procedures to ensure that their controls, as they relate to accurate research and analysis and voting services, are adequate.

2. <u>Proxy advisory firms should be required to have their work audited annually.</u>

Just as public companies are subject to strict auditing requirements and assurances regarding internal controls, so too should proxy advisory firms be required to provide more assurances and public disclosure regarding the reliability and accuracy of the voting services they provide. Over the years, there has been a growing concern about the reliability of the voting services provided by proxy advisory firms. In a 2008 article about a material voting tabulation error by another service provider, ISS's special counsel admitted that voting errors are <u>not</u> rare and that "[t]here's plenty of room for slippage."[27] The concept release referenced an example of a "technical error" in the transmission of a proxy vote by ISS to another service provider that caused a shareholder's position to be voted incorrectly with respect to the 2009 annual meeting of a financial services company. In fact, this "error" initially caused the company to report to its shareholders that a shareholder proposal received a majority vote, when in fact the proposal had not received such majority.

Against that backdrop, proxy advisory firms should be required to have their work audited periodically, no less than once per year, by independent audit firms to assess the accuracy of the votes they have cast on behalf of their institutional investor clients. Management of the proxy advisory firms should be required to provide publicly-disclosed certifications regarding the internal controls for the voting services they provide. Furthermore, proxy advisory firms should be required to immediately publicly disclose any significant errors made in executing voting instructions on a particular proxy vote.

3. <u>Proxy firms should be required to give companies a meaningful opportunity to comment on their draft recommendations.</u>

Additionally, in light of the significant influence proxy advisory firms exert, the SEC should adopt rules requiring proxy advisory firms to give companies a meaningful opportunity to comment on draft recommendations to correct any misstatements or omissions in the draft report. It is surprising and disappointing that this item needs to be required by

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[27] Nicholas Rummell, *Institutional Investors Chafe Under Power of Big Shareholder Vote Counter*, PENSIONS AND INVESTMENTS (August 26, 2008).

regulation. However, some proxy advisory firms do not allow any opportunity for issuers to review or comment on draft recommendations, and others only allow one or two days. This is clearly insufficient and therefore the rules must ensure that issuers have ample opportunity to adequately review these reports and provide meaningful input. Furthermore, there should be a formal appeals process available to issuers who have disagreements with factual statements that are contained in draft recommendation reports. In light of the considerable weight given to these recommendations, any unresolved disagreements between a proxy advisory firm and a company should be published in a separate section in the final recommendation report.

D. The SEC should adopt regulations providing for more oversight of institutional investors' activities with respect to proxy voting.

1. Institutions have a fiduciary obligation to maximize the economic value of their investors when they make voting decisions.

SEC rules require investment companies and investment advisers to adopt policies and procedures to ensure that proxies are voted in the best interests of their shareholders and clients,[28] but it is clear that many of these investors, who are extremely sophisticated, appear to be outsourcing their voting decisions to proxy advisory firms, i.e., to third parties that do not bear any responsibility for, or share any economic risk with regard to, the issuer in question. As recently noted by the Commission, "institutional investors, whether relying on proxy advisory firms or not, must vote the institutions' own shares and, in doing so, must discharge their fiduciary duties to act in the best interest of their investors and avoid conflicts of interest; institutions are not relieved of their fiduciary responsibilities simply by following the recommendations of a proxy advisor."[29] Similarly, in 2008, the Department of Labor noted that when pension plan fiduciaries vote, they have a duty to consider only the factors that relate to the economic value of the plan's investment and "shall not subordinate the interest of the participants and beneficiaries in their retirement income to unrelated objectives."[30] This clearly supports the notion that these investors have a fiduciary duty to vote in a way to maximize the economic value of their fund; merely outsourcing their proxy voting decisions does not satisfy this duty.

[28] Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, SEC Release No. IC-25922, 68 Fed. Reg. 6,564 (February 7, 2003), *available at* http://www.sec.gov/rules/final/33-8188.htm; and Proxy Voting by Investment Advisers, SEC Release No. IA-2106, 68 Fed. Reg. 6,585, *available at* http://www.sec.gov/rules/final/ia-2106.htm.

[29] SEC Release No. 34-60215 (approving amendments to NYSE Rule 452), July 1, 2009, p. 26, *available at* http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf (hereinafter "Rule 452 Release").

[30] Department of Labor Interpretative Bulletin Relating to Exercise of Shareholder Rights, October 17, 2008, *available at* http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=21630&AgencyId=8.

2. Institutions have inadequate controls and processes to ensure that the proxy advisory firms they hire are voting as directed.

Equally troubling are the concerns raised by the SEC in a 2008 Compliance Alert, which was the result of the SEC's staff compliance examinations of investment advisers, investment companies, broker-dealers, transfer agents, and other types of registered firms to determine the level of these firms' compliance with federal securities laws and rules.[31] While reviewing the internal controls at these firms, the SEC found instances of inadequate internal controls, lack of proper documentation and inadequate public disclosure.[32] The Alert concluded that some institutions had policies and procedures that contained inaccurate information or were not followed.[33] The Alert also noted that processes were not always in place to ensure that the proxy advisory firms hired by investors to handle the physical mechanics of voting were doing so consistent with the policies and procedures of the investor.[34] It is obviously very troubling that certain funds' votes are not being voted consistent with their voting guidelines. This has the effect of skewing the results of annual meeting votes, which in the case of a close vote could be the difference between a proposal passing or failing.

3. The SEC should amend Form N-PX to require increased disclosure of institutions' voting patterns.

Against the backdrop of the aforementioned influence of proxy advisory firms and the insufficient public disclosure by these investment advisers, Form N-PX should be amended to require institutional investors to disclose the proxy advisory firm(s) to which they subscribe with respect to their holdings. Further, the form should be amended to add an additional column requiring disclosure of whether the institution voted "with" or "against" the recommendations of the proxy advisory firm(s) to which they subscribe with respect to each matter voted.

By way of explanation, Form N-PX currently includes a column that requires institutional investors to disclose if their vote on each item was consistent with management's recommendation. Even though management's recommendation is disclosed in a company's proxy statement, the SEC nevertheless requires this specific line item information in Form N-PX to highlight publicly if the investors are merely voting the "company line." The logic for similar disclosure is even stronger when applied to proxy advisory firms, whose voting recommendation reports are not publicly disclosed. To be clear, we do not endorse the position that institutions should not be able to subscribe to proxy advisory services that

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[31] U.S. Securities and Exchange Commission, Compliance Alert (July 2008), *available at* http://www.sec.gov/about/offices/ocie/complialert0708.htm.

[32] Id.

[33] Id.

[34] Id.

provide recommendations and advice on proxy matters; however, the institution itself should carefully consider all of the issues presented in order to make decisions based on maximizing the economic value of its shareholders' investments and disclose to its holders the role that advisory firm(s) play in voting decisions.

II. The SEC Should Address Issues Related to Institutional Voting, Including Reforming the NOBO/OBO System and Addressing the Separation of Economic Value and Voting Interest.

A. The SEC needs to reform the NOBO/OBO system.

1. Background.

Paramount to the exercise of good corporate governance is a strong line of communication between a company and its owners. The Commission has recognized this essential fact and has introduced several initiatives designed to increase communications. For instance, the SEC has facilitated the use of shareholder forums aimed at increasing the dialogue among issuers, shareholders and other interested third parties.

Currently, beneficial owners have the option to allow information related to their names, addresses and holdings to be provided to issuers (these "non-objecting beneficial owners" are often referred to as "NOBOs"). By contrast, a beneficial owner can object to the disclosure of this information to the issuer (and such "objecting beneficial owners" are often referred to as "OBOs"). These archaic NOBO/OBO distinctions developed due to the takeovers of the 1970s and 1980s where there was concern about information becoming available to corporate raiders. This is no longer the hot button issue it once was over twenty years ago.

According to a report cited in the concept release, it is estimated that between 52% and 60% of all shares are held by OBOs.[35] Thus, the average issuer cannot easily communicate with a majority of its shareholders. Even though OBOs may be contacted by an issuer's agent, this mode of communications is time-consuming, ineffective and inefficient. Furthermore, as it relates to NOBOs, obtaining their information often comes at a great expense, which may present an economic barrier to communications. Depending on the number of beneficial owners of a company, it can cost over $100,000 to obtain a NOBO list.

Communications difficulties are especially troublesome against the backdrop of significant corporate governance developments over the last several years, including the elimination of broker discretionary voting in uncontested director elections, the increased use of majority voting in uncontested director elections and the increasing number of contested issues at shareholder meetings. Most recently, in the last few months, the SEC issued final rules allowing for shareholder proxy access, and "Say on Pay" has now become a legislated requirement for all U.S. public companies. All of these developments have made it even

[35] Release, 75 Fed. Reg. at 42,999.

more important for issuers to have the ability to communicate directly with their shareholders and to communicate throughout the entire year, not just in the period immediately preceding the annual meeting.

2. The SEC should eliminate NOBO/OBO distinctions. Short of this step, the SEC should adopt the "annual NOBO system" discussed in the concept release.

The recent developments regarding proxy access and "Say on Pay" underscore the necessity of significantly reforming the NOBO/OBO system. While we believe that suggested incremental steps such as requiring that NOBO be the default position when a beneficial owner opens an account and having investors periodically reaffirm their status are steps in the right direction, we believe that the time has come to eliminate these distinctions altogether.

Short of eliminating NOBO/OBO distinctions, we would also support the SEC's suggestion to implement an "annual NOBO system," whereby at one point each year, the record date, shareholders cannot hide their identities. This is not unduly burdensome to institutional investors that elect OBO status because it would be similar to existing obligations they have to disclose their holdings quarterly on Form 13F. In essence, this would create only one additional checkpoint for these institutions to disclose their holdings at a point in time that would facilitate company communications on annual meeting matters.

The SEC notes that the majority of OBOs are institutional investors.[36] So while personal privacy has been a cited rationale for maintaining these distinctions, there is no such concern as it relates to large institutions. Therefore, we believe that issuers should be allowed to obtain information about shareholders who would otherwise be OBOs from the period between the record date and the annual meeting date. It is important to note that this compromise is not a perfect solution because it would still be difficult for issuers to communicate with a large percentage of their shareholders for a majority of the year, which is increasingly troublesome in light of the new proxy access rules and "Say on Pay" vote.

B. The SEC should address issues related to the separation of voting rights and economic ownership, including increased disclosure of certain hedging activities.

The SEC should also take steps to ensure that companies and their shareholders are better informed about the holdings of institutional investors, particularly given that institutional investors may more actively trade their shares than individual shareholders.

As discussed above, registered institutional investment managers are required to submit a Form 13F filing on a quarterly basis. In addition to the incremental disclosure pursuant to the annual NOBO system discussed above, we suggest that the SEC require more

[36] Release, 75 Fed. Reg. at 42,999, n. 153.

frequent Form 13F filings to allow companies to identify their major shareholders more accurately. It is our view that a monthly reporting mechanism would strike the appropriate balance without causing undue burden on money managers, given advances in technology and the bookkeeping requirements already in place for broker-dealers and investment advisers.

There also needs to be a more level playing field between institutions with obligations to submit Form 13F filings and unregistered institutions such as hedge funds. This is consistent with SEC Chairman Mary Schapiro's testimony last year before the House Capital Markets Subcommittee, where she noted the SEC's continued focus on increasing transparency and oversight of meaningful market transactions.[37]

Currently any shareholder who owns 5% or more of a company's outstanding stock must disclose its holdings on a Schedule 13D or Schedule 13G. To further level the playing field, any shareholder who has an interest in a company's equity in this amount, whether through the traditional net long position or via a short sale or any other hedging activity, should similarly be required to publicly disclose these holdings.

Finally, in light of the recently-adopted proxy access rules, the SEC should also impose a requirement on shareholders who nominate directors at a company under these new rules to provide certain information to the market and to their fellow shareholders. New Schedule 14N requires that nominating shareholders disclose their share ownership in the company.[38] However, they are not required to disclose whether they have hedged their position. We suggest that the Commission mandate that any person nominating a director pursuant to the proxy access rules publicly disclose to what extent they have hedged their economic interest during the requisite holding period.

III. The SEC Should Not Change the Requirements for Publication of Annual Meeting Agenda Items

A. The SEC should not propose rules that would require earlier disclosure of a company's annual meeting agenda.

The Company does not believe that the Commission should require earlier disclosure of the annual meeting agenda. The Commission cites no empirical evidence to indicate that shareholders in general desire this information or would make different investment decisions if they had this information any earlier than the public release of the

[37] Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission, "Testimony Concerning SEC Oversight: Current State and Agenda, July 14, 2009, *available at* http://sec.gov/news/testimony/2009/ts071409mls.htm; *see also* SEC Press Release 2009-165, *SEC Charges Perry Corp. With Disclosure Violations in Vote Buy Scheme*, July 21, 2009, *available at* http://sec.gov/news/press/2009/2009-165.htm (regarding hedge fund failure to disclose beneficial ownership in public company).

[38] SEC Release No. 33-9136, "Facilitating Shareholder Director Nominations," September 16, 2010, 75 Fed. Reg. 56,668, *available at* http://sec.gov/rules/final/2010/33-9136fr.pdf.

proxy materials. The SEC's sole stated driver for raising this issue is that some institutional securities lenders may have proxy voting policies in place that require the recall of loaned securities in the event of a "material vote."[39] We firmly believe that director elections are by their very nature "material" matters and therefore, institutional securities lenders who have such a policy should call back their loans automatically. In fact, the SEC itself in the Rule 452 Release stated that the election of directors is a "critical" matter to be voted upon by shareholders.[40] Further, the election of directors will only continue to increase in importance now that the SEC has promulgated final proxy access rules.

In any event, requiring earlier disclosure of the annual meeting agenda would also not be practical. As the SEC notes in its concept release, "it can be difficult for issuers to disclose complete meeting agendas in advance of the record date because the agenda may not be established."[41] Many public companies set their record date for the annual meeting as close to 60 days prior to the meeting as possible, the maximum period permitted by Delaware and New York state laws, to ensure maximum flexibility with complex printing and distribution schedules.[42] For example, IBM's record date is typically in late February. Under a new regime, IBM would likely have to publish its agenda at the beginning of February. However, many matters are not necessarily settled by this time. For instance, management and the Board may still be considering initiatives in the form of management proposals. Also, the full slate of director nominees proposed for election might not yet be definite.

Additionally, often no-action requests related to Rule 14a-8 shareholder proposals are still pending at the Commission, including the opportunity to timely file reconsideration requests and/or appeals. At IBM, over the last ten years, there have been six no-action requests that were not resolved until February, including one as late as March 2, 2000, which was only twelve days prior to the filing of the proxy statement and one day *after* the record date.[43] Last year, IBM had a pending reconsideration of a no-action request open until February 22, just four days prior to the record date.[44]

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[39] Release, 75 Fed. Reg. at 42,993.

[40] Rule 452 Release at p. 45.

[41] Release, 75 Fed. Reg. at 42,994.

[42] NY BCL Section 604(a); Del. General Corporation Law Section 213(a).

[43] *See* International Business Machines Corporation (Publicly Available February 22, 2010) (reconsideration denied - Boston Common Asset Management et al - Say on Pay); International Business Machines Corporation (Publicly Available February 2, 2005) (granting no-action request to incoming letter request dated November 26, 2004); International Business Machines Corporation (Publicly Available February 18, 2003) (denying no-action request to incoming letter request dated December 18, 2002 -- regarding proof of beneficial ownership); International Business Machines Corporation (Publicly Available March 2, 2000) (granting no-action request to incoming letter request dated December 22, 1999 -- regarding ordinary business matter); International Business Machines Corporation (Publicly Available February 27, 2000) (granting no-

Recognizing the inherent limitations of requiring an issuer to publish a final agenda in advance of the meeting record date, the SEC requests comments on whether it should instead propose rules requiring issuers to publish an agenda that could be "subject to change."[45] We believe that this alternative confirms the notion that early publication of an annual meeting agenda would not ensure that institutional securities lenders receive timely and accurate notice of all items to be considered at the annual meeting. For instance, many of the proposals that are the subject of 14a-8 challenges may be the very proposals these shareholders deem "material." Following the SEC's logic, if shareholders recalled loans for the sole purpose of voting for or against that certain proposal, they would not have that opportunity if the SEC grants no-action relief after the meeting record date. Moreover, if a preliminary agenda was required to include all items that remain open, companies could be disadvantaged by having to disclose a potential management request for approval, which may not be ultimately included in the final proxy statement. Therefore, in light of the foregoing, we believe that the decision as to whether to publish a meeting agenda before the filing of a proxy statement should not be mandatory and instead should be at the discretion of the issuer.

B. IBM would support earlier disclosure of a company's annual meeting record date.

Currently, the New York Stock Exchange requires companies to notify the exchange of their annual meeting dates and the corresponding record dates for establishing which shareholders are entitled to vote at their meetings.[46] A minimum of ten days' notice is required prior to the record date.[47] However, the rules do not include a requirement to publicly disclose this information. In the concept release, the SEC discussed whether they should propose rules requiring issuers to publicly disclose their annual meeting record date earlier. If proposed, we would support such a rule change.

IV. Conclusion

In summary, we recognize the complexity of the issues presented by the SEC and applaud the Commission for taking up so many of these matters at this critical juncture. Since the SEC has seen fit to promulgate final proxy access rules prior to addressing these

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action request to incoming letter request dated December 21, 1999 -- regarding the legality of the course of action proposed by the shareholder); and International Business Machines Corporation (Publicly Available February 16, 2000) (denying no-action request to incoming letter request dated November 22, 1999 -- regarding cash balance pension plans).

[44] *See* International Business Machines Corporation (Publicly Available February 22, 2010) (reconsideration denied - Boston Common Asset Management et al - Say on Pay).

[45] Release, 75 Fed. Reg. at 42,994.

[46] NYSE Listed Company Manual § 401.02.

[47] Id.

significant issues, we urge you to address these "proxy plumbing" requirements as soon as possible, in particular increasing the regulatory oversight of proxy advisory firms.

As the Commission proceeds with its next steps, we would be pleased to discuss with the Commission or its staff any questions you might have about this letter or to provide you with any other assistance. Please feel free to contact me at 914-499-6118.

Sincerely,

Andrew Bonzani
Vice President, Assistant General
Counsel and Secretary