

March 31, 2004

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

Re: File No. S7-19-03

Dear Mr. Katz:

The Council of Institutional Investors, an organization of more than 140 public, corporate and union pension funds with more than \$3 trillion in investments, urges the Commission to approve the proposed amendments to the proxy rules to give shareowners limited access to management's proxy card to nominate directors.

The Council is aware that the Commission has received extensive and opposing opinions on the proposed reform. The Council believes the suggested access mechanism is a measured proposal that would give shareowners a tool usable at a limited number of companies with meaningful evidence of governance problems.

The Council's views on the proposal are detailed in its Dec. 12, 2003, comment letter, which was co-signed by the National Association of State Retirement Administrators (NASRA), a group representing directors and administrators of state employee retirement plans with combined assets exceeding \$1.4 trillion, and the National Council on Teacher Retirement, a group representing 77 state, territorial, local, and university pension systems serving more than 16 million active and retired teachers, non-teaching personnel, and other public employees and holding combined assets of more than \$1.4 trillion.

This letter follows up by addressing the primary arguments advanced by those opposing the proposed reform.

First, the reform should not be tabled to give companies and investors time to “digest” reforms mandated by the Sarbanes-Oxley Act of 2002, new SEC rules/regulations and the stock exchanges.

The reform under consideration by the Commission addresses a critical issue—the ability of shareowners to truly act like owners by having a meaningful vote on who represents them on corporate boards—that has not been addressed by any of the recent corporate reforms.

The corporate scandals of the past few years highlighted an ongoing, longstanding problem: shareowners are powerless to efficiently and effectively replace directors who are not doing the work expected of them by their employers, the shareowners.

The SEC's recently adopted rules requiring enhanced disclosure of the director nomination process are an important supplement to the proposed access reform. However, the disclosure rules should not be considered a replacement for access reform, which would give shareowners the limited ability to take the next step and replace underperforming directors.

The average Council fund invests more than 75 percent of its total portfolio in U.S. stocks and bonds; equity holdings represent about 40 percent of the average fund's total portfolio. By virtue of their size and the significant percentage—on average 45 percent of their domestic equity portfolios—of their passive holdings, Council members cannot “take the Wall Street walk” and sell their holdings.

Currently Council members and other long-term shareowners can only address director problems by running an expensive and complicated proxy fight—an unworkable alternative for most shareowners, particularly fiduciaries such as Council members who must evaluate whether the very significant costs of a proxy contest are in the best interests of plan participants and beneficiaries.

Reasonable access to company proxy cards for long-term shareowners, as crafted by the proposed rule, would address some of these problems. We believe such access would substantially contribute to the health of the U.S. corporate governance model and U.S. corporations by making boards more responsive to shareowners, more thoughtful about whom they nominate to serve as directors and more vigilant about their oversight responsibilities.

Second, the access reform should be supplemented by, not replaced with, suggested listing standard changes imposing certain penalties if a majority of shares are withheld from a director.

The Council views the access rule and listing standard approaches as complimentary. The listing standard reforms suggested by Ira M. Millstein and Joseph A. Grundfest would restore significance to the election of directors—a vote that currently is meaningless due to broker votes and plurality voting requirements. However, their suggested compromises would fail to give shareowners the ability to efficiently and simply run alternative candidates for the board.

Another concern with the listing standard approach is that the stock exchanges have long histories of dragging their feet on reforms opposed by their listed companies. Changing the rules to require shareholder approval of equity plans took more than five years. The Council is concerned that changes such as the ones proposed by Mr. Grundfest and Mr. Millstein would take decades—if ever—to be approved by the exchanges.

Third, voting should be based on votes cast, not outstanding shares, and the withhold vote threshold should remain at no more than 35 percent of the votes cast.

The Council is disappointed with company suggestions that voting requirements for the proposed triggering events should be based on a majority of the outstanding shares. Companies currently are more than happy to conduct business with the approval of less than a majority of the outstanding shares. Most directors must only be approved by a plurality of votes cast; equity compensation plans are routinely passed by a majority of the votes cast; and supermajority voting requirements ensure that actions may be blocked even if approved by a majority of the outstanding shares.

The Council is confused why the voting bar should be raised for shareowners. The Council strongly believes that the triggers should be based on votes cast, not votes outstanding.

We also believe that the withhold vote trigger should be set at no more than 35 percent of the votes cast. A higher threshold would render the trigger meaningless.

The Council's random survey of 2003 director votes at 100 S&P 500 firms, 100 S&P MidCap 400 companies, and 108 S&P SmallCap companies found no companies reporting that at least one director received a withhold vote of more than 50 percent of the votes cast. Lowering the requirement to 35 percent of the votes cast resulted in only six companies (two S&P Midcap, four S&P SmallCap and no large cap companies)—2 percent of the entire survey group—meeting the threshold. (Of note, the information provided by Automatic Data Processing overestimates the number of companies with 35-plus percent withheld votes, because it only includes votes tallied by ADP. The ADP information is a helpful first run, but it must be scrubbed to evaluate the actual voting results at these companies.)

Fourth, the proposed reform would not give disproportionate or unreasonable power to proxy advisory firms.

Council members and other institutional investors have a fiduciary duty to vote proxies in the best interests of plan participants and beneficiaries. As a result, they do not make voting decisions—whether withholding votes from directors, supporting shareowner resolutions or suggesting director candidates—on a whim.

Concerns that the reform would increase the power of Institutional Shareholder Services, the nation's proxy advisory firm, are overblown for the following reasons:

- The largest institutional money managers, along with most of the Council's largest members, have their own voting guidelines. They may purchase research from ISS or other advisory firms, but they do not "blindly" follow the recommendations. On complex issues, including ones that would be raised by the access mechanism, they generally have case-by-case policies requiring careful review and analysis before voting decisions are made.

None of the Council's 10 largest public fund members, with pension assets totaling \$750 billion (representing about a third of all assets held by public pension funds, according to a recent Conference Board report), base their domestic proxy votes solely on ISS recommendations. In each case, their domestic equity holdings are voted based on the funds' own proxy voting guidelines.

- More than 70 percent of the equity holdings of all institutional investors—which represent around 56 percent of the total U.S. equities market—are held by corporate pension funds, mutual funds, bank trust funds and insurance companies that tend to support management’s recommendations.
- The Council believes that the number of institutional investors, particularly mutual funds, voting based on their own guidelines will increase in the future, due in part to the SEC’s new rules requiring greater disclosure of proxy votes by mutual funds and money managers.
- Competition is increasing in the proxy advisory business, and the Council believes that institutional investors will increasingly rely on more than one firm for proxy voting advice, particularly on complex issues.
- The Council expects that institutional investors will be even more careful in the future on voting items that may trigger the access mechanism in the future.

Fifth, special interest representation is impossible under the proposed reform.

As proposed, shareowners would only be able to nominate a candidate after one of two “stretch” thresholds—a 35 percent withhold vote for at least director candidate or a 50 percent vote on a shareowner proposal sponsored by a 1 percent owner/group to opt into the access mechanism—are met. Both are tough triggers requiring majority or close-to-majority support of owners.

Once a threshold is satisfied, candidates suggested by 5 percent owners are elected only, assuming plurality voting requirements, if vote tallies for the candidates exceed those cast for board-nominated candidates.

Given the fact that the candidates must be approved by a plurality or majority of votes, the Council is frankly why companies would argue that these duly elected directors would be “special interest” directors.

Sixth, the proposed reform includes numerous safeguards against excessive, abusive use of the mechanism.

The two triggers, the 1 percent ownership requirement for submitting an access opt-in resolution and most significantly, the 5-percent-for-two-continuous-years ownership requirement for director nominations would limit the mechanism to a small number of companies.

The 5-percent-for-two-years ownership requirement is particularly stringent.

Institutional investors, which are more likely than individual investors to be eligible to use an access mechanism are not a monolithic block, and institutional ownership of U.S. equities is fragmented.

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The handful of the nation's largest money management firms, who in many cases may own more than 5 percent of a company's outstanding shares, are likely to vote their proxies, but they are unlikely be involved in more assertive activities, such as filing shareowner resolutions or running candidates for director.

In terms of corporate governance efforts, the most active institutional investors have tended to be public pension funds, which in aggregate own **only 8 percent** of total U.S. equity market.

The Council expects, and comment letters from the corporate community suggest, that other institutional investors such as corporate pension funds, mutual funds, insurance companies, bank trust departments—which in aggregate own about 40 percent of U.S. equities, are unlikely to use the mechanism.

Finally, additional time is not needed to study this reform.

Sixty years have passed since the Securities and Exchange Commission first considered whether shareowners should be able to include director candidates on management's proxy card. This reform has been studied for decades and is long overdue.

The Council believes its adoption would be the single most significant and important investor reform adopted by any regulatory or legislative body in decades. We congratulate and thank the SEC for its leadership in this important area.

The Council appreciates this opportunity to comment. Please contact me with any questions.

Sincerely,

A handwritten signature in blue ink, appearing to read 'S.A.B. Teslik', with a stylized flourish at the end.

Sarah A.B. Teslik
Executive Director

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey J. Goldschmid
Alan L. Beller, Director, Division of Corporation Finance
Martin P. Dunn, Deputy Director, Division of Corporation Finance