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Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Attention: Ms. Elizabeth M. Murphy, Secretary

Re: File No. S7-14-10
Release Nos. 34-62495; IA-3052; IC-29340
Concept Release on the U.S. Proxy System

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities of the Section of Business Law of the American Bar Association. It also reflects significant input from the Committee on Corporate Laws and the Corporate Governance Committee of the Section. (The three Committees together are referred to in this letter as the “Committees.”) This letter is submitted in response to the request for comments by the Securities and Exchange Commission (the “Commission”) in its July 14, 2010 release referenced above (the “Concept Release”).[1] The comments expressed in this letter represent the views of the Committees only and have not been approved by the American Bar Association’s House of Delegates or Board of Governors, and therefore do not represent the official position of the American Bar Association (the “ABA”). In addition, this letter does not represent the official position of the ABA Section of Business Law.

The Committees support the thorough examination of proxy voting mechanics and related issues that the Commission has begun with the Concept Release, and are pleased to have the opportunity to comment. The Commission has undertaken its examination of proxy mechanics in furtherance of its mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The functioning of the proxy voting system is integrally related to each element of the Commission’s mission.

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1 Concept Release on the U.S. Proxy System, SEC Rel. Nos. 34-62945; IA-3052; IC-29340 (Jul. 14, 2010), 75 Fed. Reg. 42,982 (Jul. 22, 2010)(“Concept Release”) (to be codified at 17 C.F.R. pts. 240, 270, 274, 275).

In that regard, the Committees view a properly functioning proxy system as a vital component of the nation's corporate governance framework. The Committee on Corporate Laws, in its recent report regarding the roles of boards of directors and shareholders of publicly owned corporations (the "Report"),[2] stated clearly that effective shareholder input is a crucial element of effective corporate governance for publicly owned corporations. The Report strongly supports the centralized model of corporate governance for publicly owned corporations, which gives the board of directors power and corresponding responsibility to direct and oversee the management of the corporation. The Report notes that "[f]or diversified long-term investors, the benefits of this model are considerable."[3] The Report also emphasizes that, as a corollary to the centralized model, accommodation should be made for the increased shareholder scrutiny resulting from increased institutional ownership and sometime shareholder dissatisfaction with board and management performance. More specifically, the Report recognizes the importance of shareholder involvement in the director selection process, as follows:

> The Committee believes that shareholders should have the right, as owners of the enterprise, to participate in a meaningful way in the selection of the individuals who have responsibility for directing the management of the enterprise. The Committee recognizes that a governance model in which the board has broad authority and oversight responsibility gives shareholders a compelling interest in the quality of the board selection process.[4]

The legitimacy of all voting activities relating to the director selection process depends on the quality of the voting process and therefore, for publicly owned corporations, on the quality of the proxy process. This axiom applies equally to all other significant matters put to a shareholder vote.

Moreover, the legitimacy of the voting process has never been more important. As the Concept Release notes, an important confluence of events has made the act of voting more consequential. These events include the following:

- the development of majority voting as a common standard at the largest companies and its possible growing use elsewhere;

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2 Comm. on Corporate Laws, ABA Section of Bus. Law, *Report on the Roles of Boards of Directors and Shareholders of Publicly Owned Corporations and Changes to the Model Business Corporation Act—Adoption of Proxy Access Amendments to Chapters 2 and 10*, 65 Bus. Law 1105 (2010).

3 *Id.* at 1108.

4 *Id.* at 1109.

- the modifications to Rule 452 of the New York Stock Exchange, including those mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), to cease to permit uninstructed broker voting for election of directors and executive compensation matters; and

- the adoption by the Commission of Rule 14a-11 (currently the subject of litigation) providing for shareholder nomination of candidates for director, subject to certain conditions, and the amendment by the Commission of Rule 14a-8 to permit shareholder proposals regarding procedures for inclusion of director candidates in company proxy materials.

Recent developments have increased the importance of not only the act of voting, but also the matters subject to shareholder votes. The election of directors in a new world that features majority voting, "vote-no" campaigns, increasing numbers of short-slate nominees and the new possibility of access nominees, is a notable example. The requirement imposed several years ago on New York Stock Exchange- and NASDAQ-listed companies to obtain shareholder approval of equity plans is another. The say-on-pay advisory votes imposed by the Emergency Economic Stabilization Act of 2008, followed by the new executive compensation advisory votes imposed by the Dodd-Frank Act (say-on-pay, say-on-frequency, and say-on-golden parachutes), are another. It is clear that the matters up for a vote have become increasingly important to both corporations and their shareholders.

Finally, because the corporate governance model that the Committees favor, when functioning properly, provides important benefits for investors, contributes to fair, orderly and efficient markets, and fosters capital formation, the Committees believe that a properly functioning proxy system helps further all elements of the Commission's mission and strengthens corporate governance for the benefit of corporations, their shareholders and the economy.

At the outset, we note that the Commission's task is made more difficult and complex because it involves regulating the processes surrounding the voting rights of a group of investors that, for the most part, are not registered owners and thus generally are not granted voting rights under state law. In other words, the proxy voting system itself creates the framework under which most beneficial owners not only exercise voting rights, but also effectively obtain them. Moreover, the system of "street-name" beneficial ownership was designed primarily to facilitate efficient capital markets, with little consideration given to the framework for the exercise of voting rights.

Since beneficial owners effectively obtain voting rights through the proxy system, changes to proxy mechanics can affect the nature and exercise of those rights. Proxy mechanics and changes to those mechanics can, for example, favor certain types of investors over others, to a greater or lesser degree. As a general matter, the Committees believe that the Commission's proxy framework should be neutral as among different types of investors. Moreover, we believe that the proxy framework should continue to be the mechanism whereby beneficial owners effectively obtain voting rights, and that this framework should not interfere with state law that regulates the parameters of the substantive voting rights of registered owners (as we discuss further below). Finally, any changes to proxy mechanics must of course be consistent with the objective of maintaining an ownership system that facilitates efficient capital markets.

The Committees believe that the proxy process would be best examined and most likely be improved, and that both the Commission's mission and an effective corporate governance model would be best furthered, if the examination of proxy mechanics, and any resulting regulatory modifications, seek to satisfy the broad objectives set forth below. The Committees have sought in the body of this letter to make observations, suggestions and recommendations that we believe are consistent with, and indeed support, these broad objectives:

- *Promote accuracy and transparency in the proxy solicitation and voting processes and foster the perception among participants that such accuracy and transparency exist.*

The legitimacy of any shareholder vote is founded on its accuracy. As shareholder votes become more consequential, the importance of their accuracy and legitimacy is highlighted. As discussed in the Concept Release and emphasized above, corporate governance developments have increased the significance of shareholder votes and the importance of accurate tallies. We also agree with the Commission that a perception exists among some issuers and investors that the current proxy system lacks transparency and sometimes results in, or contributes to, inaccuracies in the voting process.[5] Further, we agree that a lack of confidence in the proxy voting process harms investor and issuer interests. Parts I.A through I.C of this letter discuss our recommendations related to enhancing the accuracy and transparency of the proxy solicitation and voting processes; Part I.D deals with the impact on these processes of institutional share-lending practices. We believe that the improvements on which we focus also will promote confidence among investors, issuers and other proxy system participants. We also discuss the need for a careful cost-benefit analysis, a particularly important inquiry where implementing potential improvements to the system may impose significant additional costs on some participants, given the interrelated nature of the various links in the proxy voting system.

As an initial matter, the Committees believe that changes to the existing "OBO/NOBO" system, in which issuers and others who seek to solicit proxies may not contact beneficial owners that object to disclosure of their identities to the company (so-called "objecting beneficial owners" or "OBOs"), should be considered. Limiting or eliminating OBO status may help make possible many of the suggested further changes relating to communications and direct voting discussed in this letter. In particular, such a step would facilitate direct communications between issuers and beneficial owners and among beneficial owners. In addition, eliminating the current OBO system could facilitate other regulatory modifications that could provide for direct proxy voting by beneficial owners, and thereby could enhance the accuracy and transparency of the

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5 One important step in analyzing ways to improve the accuracy and transparency of the proxy voting process would be for the Commission to seek better information as to whether and to what degree breakdowns in the voting process have occurred, and how any such breakdowns have been addressed (if at all) by various proxy participants.

proxy voting system. While data security and privacy interests must be considered in evaluating changes to the OBO/NOBO regime, we do not believe they are insurmountable obstacles. The Commission should evaluate, first and foremost, whether the changes to communications and/or voting that would be permitted through changing the current regime are worthwhile.

- *Encourage voting by all categories of investors by eliminating structural and practical impediments*.

Broad participation in shareholder voting enhances the authority of those votes cast as expressions of investor views and priorities. We believe that shareholder voting will have more legitimacy, and will be considered as such, if barriers to voting for all groups of investors, particularly retail investors, are reduced. We therefore support the Commission's goal of promoting shareholder voting in general, and raising participation rates among retail investors in particular.

We believe that facilitating direct communications, to the extent corporations and others soliciting proxies choose to engage in them, is important to encouraging the development of practices and mechanisms to increase voting participation, especially by retail investors. Part II describes our recommendations on this subject. These recommendations reflect our view that existing rules create structural and practical impediments to voting by beneficial owners, and that these impediments could be reduced or eliminated consistent with the Commission's mandate of investor protection. Such changes would, we believe, encourage the development of more convenient, accessible and investor-friendly mechanisms for communication with, and voting by, beneficial owners.

We believe it is especially important to have structures in place that would facilitate retail participation if those soliciting proxies in connection with a shareholder action, or those otherwise interested in the action, make a determination to encourage such retail participation in respect of particular votes. In this regard, the limitation or elimination of OBO status could yield meaningful improvement without causing significant disruption to the existing framework.

- *Provide an appropriate regulatory framework for those seeking to solicit proxies or encourage provision of proxies*.

The development of new mechanisms for proxy voting and new channels of communication with beneficial owners must take place within a regulatory framework that protects investors. For example, as we discuss in Part II, mechanisms such as advance voting instructions would represent a significant change from the existing proxy disclosure regime as it applies to individual investors. Analogous mechanisms, of course, have long been in place for institutional investors. We recognize that such mechanisms raise significant policy questions about what regulatory criteria must be met in connection with asking an investor to make a voting decision. While the Committees support steps to make proxy materials less opaque and cumbersome and easier to understand, the Committees believe the Commission's choice of criteria relating to a voting decision should not turn on whether or not an investor has reviewed or understood available information, or on whether the voting decision reflects "engagement" with the underlying issues. Rather, regulatory attention should focus on ensuring that appropriate information is made readily available to investors. Investors may then make decisions as to the information they want to consider in making voting decisions. Part II describes our specific recommendations.

In addition, we believe that the regulatory criteria applicable to the solicitation of a proxy seeking a particular voting outcome are not necessarily the same criteria that should apply to voting-related communications with investors that do not seek a particular voting outcome. "Vote in any manner you choose, but please vote", is far different from "Please vote for Ms. Jones". As described in Part II, the Commission should therefore consider a system in which the rules expressly provide increased flexibility for efforts to encourage voting that do not seek to influence how shares are voted.

- *Provide an appropriate regulatory framework for providers of advice or information regarding proxy voting choices.*

Proxy advisory services can exert significant influence over shareholder voting and issuers' corporate governance practices. In many respects, proxy advisory services are the most prevalent example of the decoupling of economic and voting interests, and the Committees agree with the Commission that such services should be considered under this rubric, as they are in the Concept Release. In addition, institutional investors may use proxy advisory firms' recommendations to formulate voting decisions before the disclosure related to the vote is available. To date, however, the Commission's staff has expressed reservations – on policy grounds – regarding various proposals that would allow retail investors to take similar steps. As noted above, such a practice highlights fundamental policy issues that may merit further consideration on the institutional as well as retail side.

The Committees support the Commission's examination of whether existing rules appropriately regulate proxy advisory firms. Within the current regulatory framework, which includes various concepts tied to the solicitation of proxies as well as the provision of investment advice (as discussed in the Concept Release), there may be means of enhancing the regulation of proxy advisory firms. Additional regulatory approaches or frameworks might also be developed, and indeed a full evaluation of the role of proxy advisory firms necessarily will require consideration of the nature and scope of the fiduciary duties of the entities that employ these firms and of the firms themselves.

Part III describes our recommendations regarding proxy advisory firms. As a general matter, the Committees do not believe that regulation should limit or define the permissible objectives of advice or recommendations regarding proxy voting choices. However, regulation should ensure greater transparency and integrity in connection with the provision of such advice or recommendations than is now required, at a minimum with respect to the following: (1) the services performed by the proxy advisory firm; (2) the objectives of any advice or recommendation and the expected connection between the recommendation or advice and the stated objectives; (3) actual voting recommendations and any responses received from companies; (4) the controls in place regarding execution of votes, and any failures the firm has experienced in vote execution; (5) the procedures used to ensure that such advice or recommendation is developed with due care and based on factually accurate information (and the degree to which companies and other interested parties are encouraged or permitted to confirm or otherwise comment on such information); (6) the monitoring processes, if any, used to test whether and to what extent such advice or recommendation in fact achieves the stated objectives over time; and (7) any relevant conflicts of interest.

- *Foster competition in the market for provision of services in the proxy and voting systems, provided that doing so is consistent with investor protection and protection of voting and market integrity*.

The Committees understand that suggestions have been made that there be regulatory changes to permit greater market competition in the provision of various proxy services that could result in some decline in costs. Moreover, the Committees recognize that the fee schedules developed by the self-regulatory organizations may not have kept pace with regulatory and perhaps technological change. For example, the New York Stock Exchange, on the recommendation of its Proxy Working Group, decided not to incorporate delivery of proxy materials by the notice-and-access model into its fee schedules. In principle, the Committees would favor increased competition for the various aspects of proxy services that are now provided or that would be provided under a future proxy structure. However, the principle that we favor must be tested against the consequences for investor protection and voting and market integrity. Developing and evaluating any potential changes in this market would involve significant technological and logistical considerations that are beyond the expertise of the Committees and the scope of this letter.

- *Provide for increased transparency regarding arrangements that result in separation of economic ownership and voting power and eliminate impediments that would constrain state law and private ordering efforts to deal with such separation.*

The fundamental principle that owners of the enterprise have the voting power has been cast into doubt by recent developments, such as expanded short selling, securities lending and use of derivatives and other techniques. Because these are recent phenomena, there is not sufficient information to determine their extent and nature or their consequences. As discussed in Part III, both to gain such information and provide greater transparency, we recommend that the Commission expand the proxy disclosure requirements to elicit information about empty voting and other decoupling arrangements.

We also believe that, in considering proxy mechanics and any potential regulatory changes, the Commission should remain mindful of the important role of state corporate law underpinning the federal proxy rules. As the primary regulator of internal corporate affairs, for example, state corporate law governs substantive voting rights and election mechanics. State law offers a regulatory framework that is sufficiently flexible to permit evolution and fine-tuning in response to changing circumstances, including addressing consequences of the separation of ownership rights and voting power. Accordingly, any regulatory modifications of the proxy system should – to the greatest extent possible – avoid narrowing the scope for state corporate law developments in the areas of substantive voting, election mechanics, state law-mandated disclosure under the rubric of the board's duty of candor, and related matters. Indeed, such developments should be facilitated where consistent with the Commission's mission and the objectives of corporate governance as described at the beginning of this letter. The Committees recognize the importance of the Commission's role in protecting the interests of beneficial owners, as well as those of registered owners whose rights are given great deference under state corporate law. Street-name beneficial owners were effectively enfranchised under the current proxy system by Section 14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and implementing rules. Further, the Commission is uniquely positioned to require full and fair disclosure by the responsible proxy participants at appropriate points across the proxy communication and voting processes.

We recognize that many of the possible changes to the proxy system, including several of those discussed in this letter, could involve complex and interrelated alterations to the basic regulatory framework. Other possible changes, however, could be considered and adopted by the Commission on a standalone basis, even if more comprehensive reform were deferred. We believe the following topics, each of which we discuss in more detail below, are appropriate candidates for such a standalone evaluation: enhanced regulation of proxy advisory firms; additional disclosure under the proxy rules on decoupling of voting and economic interests by soliciting parties; expanding the scope of permissible "free-writing" in a proxy setting; and streamlining proxy disclosures and permitting delivery of a proxy card or voting instruction form ("VIF") with the notice under the Commission's proxy "notice-and-access" model.

Finally, it is also worth noting that, while investor protection is paramount, the regulatory framework governing proxy-related communications and voting also should reflect the value attributed by proxy system participants to various aspects of the system and the resulting financial incentives that operate on those who perform functions within the system. For example, we submit that costs should not be imposed on advisers that vote investors' shares that are out of proportion to what investors are willing to pay for those services. The possible spectrum of the fiduciary duties of those advisers should be informed by this calculus. It is worth considering how a fiduciary should determine its voting policies and votes (and even whether it should be required to vote) on all or particular matters against the backdrop of the economics to investors. (The role of proxy advisory firms should also be evaluated against this background of fiduciary duty considerations, as discussed below.)

A second example involves the business model from the point of view of issuers, intermediaries and their agents. Although fostering a reliable and transparent proxy system structured to protect investors is paramount, as noted, the Commission should pursue those objectives while considering how it imposes costs on issuers (and thus ultimately investors) and intermediaries (and thus also ultimately investors, in all likelihood). While some tension between economic incentives and regulatory requirements may be inevitable, we believe weighing costs and benefits to minimize such dichotomies wherever possible, and not otherwise inconsistent with the interests of investors, also can help minimize the risk of unintended consequences.

I. <u>Accuracy, Transparency and Efficiency of the Voting Process</u>

A. Threshold Issues

A key threshold issue regarding several topics covered in this Part I of our letter is whether the Commission determines to reform the current OBO/NOBO system in a manner that would permit, encourage or even require direct voting by all beneficial owners of securities held in street-name as of the record date for any shareholder action. As we note below, such a structure to facilitate or require direct voting is not the same as a system that would limit or eliminate OBO status, at least as of the record date, to facilitate direct communication by issuers and other soliciting parties with beneficial owners. However, a direct voting system would be a logical extension of limiting or eliminating OBO status. We discuss these issues below in Part II of this letter in the context of our consideration of the costs and benefits of the current OBO/NOBO structure. For purposes of this Part I of our letter, we will address the topics of over-voting and under-voting and of vote confirmation,

- First, on the assumption that the proxy voting system is not revised so as to eliminate the use of VIFs transmitted by beneficial owners to intermediaries (that is, there will not be a switch to direct voting by beneficial owners of street-name stock); and

- Second, on the assumption that the proxy voting process is revised to accommodate or consist solely of direct voting by execution of so-called "legal" proxies by beneficial owners of street-name stock, without the use of VIFs or other intermediation by custodians and holders of record.

B. Over-Voting and Under-Voting

1. Is Over-Voting or Under-Voting a Problem?

Although the Commission refers to over-voting and under-voting in the Concept Release in a manner that suggests that the two concepts are related, in our view over-voting is not analogous to under-voting, and we do not believe the two issues lend themselves to a common discussion. The starting point for an analysis is that custodial intermediaries provide VIFs to beneficial owners specifying a number of shares for which the VIF can be given. Over-voting, quite simply, occurs when a broker-dealer or bank participant in The Depository Trust Company ("DTC") attempts to vote more shares than are actually held in that entity's account as of the record date for shareholder action. The issue is most likely to be identified as an over-voting situation where the aggregate of shares voted by the particular DTC participant exceeds the total number of shares shown on DTC's books as being held by that participant.

Under-voting, on the other hand, is not a problem that calls into question the integrity of the voting system. Instead, it highlights the fact that beneficial owners may not be participating fully in the proxy voting process and that, as a result, their custodial intermediaries may not be voting the total number of shares that they are entitled to vote in connection with a shareholder meeting.

Returning to the issue of over-voting, although we cannot provide any specific empirical or statistical evidence, it is our understanding that, while once relatively common at the DTC participant level, over-voting has largely been eliminated through the use of the various reconciliation methodologies outlined in the Concept Release. Moreover, as suggested by the Concept Release, we believe the key reasons for requiring reconciliations at the intermediaries' level is that, as a result of share-lending by intermediaries of securities held in margin accounts and of "fails-to-deliver," the number of shares credited on the books of some intermediaries to the account of some beneficial owners exceeds the number of shares credited on the books of DTC to the particular intermediary's account. As neither of these causes is likely to be removed, we believe that the Commission should have a policy of encouraging or, perhaps, requiring reconciliation at the intermediaries' level to preclude over-voting.[6]

2. Reconciliation Methodologies

At a conceptual level, steps to improve and support the proxy voting system's actual and perceived accuracy, transparency and efficiency are clearly desirable. At a practical level, a thorough cost-benefit analysis is appropriate before undertaking significant changes to the current system. This is particularly true where changes could involve considerable added cost or complexity, as might be the case for certain possible changes addressing over-voting. Such an analysis would need to take into account the extent to which current practices contribute to actual or perceived inaccuracy, the extent of investor and company interest in possible solutions, and the costs and other burdens involved in implementing these solutions. The Committees do not have the expertise or information needed for such an analysis. However, we believe there are some readily identifiable pros and cons to the two basic reconciliation methodologies (which likewise apply to any hybrid methodology):

- Pre-reconciliation has the conceptual advantage of acknowledging the reality ofshare-lending and fails-to-deliver, and attempting to deal with the consequences at the individual account level. It reduces some beneficial owners' share positions for voting purposes by utilizing a methodology selected by the custodian to allocate to certain individual accounts shares that have been lent by the custodial intermediary, and shares that have been purchased but not delivered to that intermediary, as of the record date.

- On the other hand, pre-reconciliation fails to address the fact that, because the custodial intermediary maintains its share positions under a fungible bulk regime, there is no direct connection between the intermediary's share position and the share positions credited on its books to individual accounts. Moreover, beneficial owners may not be aware that their shares have been lent, nor are they necessarily aware that their shares may be the subject of

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6 Another approach would be to conduct reconciliation at the company level by having proxy tabulators reduce over-votes automatically by rejecting proxies constituting an over-vote on a LIFO basis. This approach, however, strikes us as a less efficient method, and one that does not promote confidence in the rationality or integrity of the voting and tabulation process because of its totally arbitrary nature.

fails-to-deliver. Although shares of street-name beneficial owners may be subject to brokerage or other agreements that authorize their broker-dealers or other intermediaries to loan the shares held, today such intermediaries generally are under no obligation to advise the beneficial owner with respect to specific lending activities.[7] As far as the beneficial owners know, they own the number of shares attributed to their accounts on the intermediaries' books. Unlike "empty voters", they have a full economic interest in those shares and can be viewed as entitled to assume that they have matching voting rights. Why should it be their problem if the intermediary is subject to fails-to-deliver that are systemic in nature or, even more so, chooses to lend shares held in fungible bulk for the economic benefit of the intermediary?

- Post-reconciliation has the obvious benefit of recognizing, to the greatest extent feasible, the economic ownership of shares reflected on the intermediaries' books. By reducing votes only when there is over-voting as a whole, post-reconciliation utilizes the voting power of the intermediary's position on DTC's books to the greatest extent feasible.

- The negative of post-reconciliation is, just as obviously, that this methodology uses votes not cast by some beneficial owners to provide shares underlying votes cast by others. While it may maximize the number of votes cast, it does so by treating votes as being held in fungible bulk and subject to allocation to beneficial owners, not on the basis of their "true economic" interest (which presumably includes the collateral for lent shares, not the shares themselves), but on the basis of the beneficial owners' relative desire to vote (or not to vote) their shares.

- Consistent with the preceding point, to the extent that the objective of the system of custodial intermediaries and beneficial owners is to place the beneficial owner in the same position as a registered owner, while providing the advantages of a "book-entry equivalent" system that promotes the efficient trading,share-lending, clearance and settlement processes necessary for modern markets, post-reconciliation leads to results that are inconsistent with that objective. Whether the federal proxy rules should lead to a different (and perhaps more advantageous) result in terms of voting rights for beneficial owners from that which would occur for registered owners under state law deserves some attention. Pre-reconciliation can provide results that are more consistent with the state-law based registered owner model.

- Moreover, as the Concept Release points out, the administrative costs of the two systems also vary, and pre-reconciliation seems to be more practical in an institutional setting and post-reconciliation in a retail setting.

We do not have the knowledge or ability to determine which reconciliation system is the most cost-effective, the easiest to administer or otherwise "better". Indeed, we are not sure that

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7 We recognize that Section 929X of the Dodd-Frank Act requires broker-dealers to notify customers that they may prohibit their fully paid securities from being used in connection with short sales and gives the Commission discretionary authority to prescribe the form and content of such notice.

the concept of "better" or "best" is a relevant inquiry in a system based on indirect voting through VIFs submitted by beneficial owners to their respective intermediaries (or intermediaries' agents) for aggregation and voting through legal proxies. That is to say, so long as the Commission does not adopt a system that facilitates or requires direct voting by beneficial owners, we do not have strong views on the desirability or feasibility of the Commission regulating reconciliation methodologies or mandating adoption of a single, universal reconciliation methodology.

We do point out, however, that were the Commission to revise the proxy voting system to encourage or require direct voting by beneficial owners, any post-reconciliation process would be compromised or rendered infeasible because the control point of the intermediary translating VIFs into proxies would be badly compromised in a mixed system of direct and indirect voting by beneficial owners, or even entirely lost in a system of mandatory direct voting. In such a revised system, the only reconciliation method that we believe would be feasible would be a "pure" pre-reconciliation process, under which proxies distributed to beneficial owners would take into account the discrepancy between the accounts of the holders and the accounts of the intermediary with respect to the total number of shares held by the intermediary as of the record date, and in some fashion reduce the aggregate beneficial owners' voting rights to the security count of the intermediary on DTC's books. As noted above, such a system would increase transparency to the extent that it ensures that beneficial owners know, at the time they vote, how many votes they are entitled to cast.

On the other hand, while such a pre-reconciliation process may be able to be formulated and, presumably, mandated by the Commission, such a process would clearly have its costs, not only administrative, but also potentially in terms of the relationship between beneficial owners and their custodial intermediaries. Under a mandatory pre-reconciliation system, every beneficial owner would be able to determine the effect of its intermediary's pre-allocation methodology (including as it reflects the impact of fails and particularly the impact ofshare-lending activity) on its voting rights. (As discussed below, we favor disclosure to beneficial owners of the reconciliation method used in their accounts and thus are not in favor of "hiding the ball" on these points in any event.) Moreover, such a mandatory pre-reconciliation system might raise issues of the legal relationship between the beneficial owner and its custodial intermediary under the Uniform Commercial Code ("UCC") and bankruptcy law, if for no other reason than because of its seeming contradiction with the concept that the intermediaries hold shares for clients in fungible bulk.

We do not mean to suggest that the difficulties of a pre-reconciliation methodology outweigh the merits of moving to a direct voting system. Achieving that regulatory balance is far more complicated and subject to too many other considerations to be dealt with here. We do, however, believe that it is important for the Commission to realize the significant inter-connection between reconciliation procedures (and the underlying over-voting concerns) and a move toward partial or direct voting by beneficial owners.

3. Should the SEC Require Broker-Dealers and Other Intermediaries to Disclose Their Methods of Reconciliation and Allocation?

We believe that many beneficial owners (particularly retail holders) do not understand that the votes that they think they are casting on a matter when they fill out their VIF may not, in fact, be counted. Nor do many of them know that they may not have the right to vote those shares because the intermediary has loaned some shares held in fungible bulk in its accounts. In fact, some of the members of the drafting committee for this letter have admitted that, prior to reading the Concept Release, they were not aware of many of the complexities of the proxy voting system (and other related systems, such as net clearing through the DTC and share-lending) nor of the differences among various reconciliation methodologies at the intermediaries' level.

We believe that transparency is critical to the integrity of any proxy voting system. The Concept Release states, in footnote 65, that the Commission "do[es] not believe there is consensus among the industry participants" with respect to methodologies used by intermediaries to allocate shares among beneficial owners and to reconcile the votes directed by beneficial owners to be cast using VIFs with the number of shares that the intermediary is actually permitted to vote according to DTC. Given the fact that there are a number of different methods used by various intermediaries to allocate and reconcile votes, at a minimum the Committees believe an intermediary should be required to disclose to the beneficial owners of the shares held in its accounts which reconciliation method the intermediary is using. The specter of beneficial owners believing that they have cast a certain number of votes when in fact they have not is simply not desirable from a policy perspective. In order for beneficial owners to have confidence in the proxy voting system, we believe that they should and need to understand not only that their voting instructions are reconciled by their intermediaries, but also how.

Accordingly, we recommend that, whether or not the Commission mandates the use of a particular reconciliation method, it should at a minimum require broker-dealers and other custodial intermediaries to disclose prominently a brief description of the material aspects of the reconciliation method applied and whether it is possible that, as a result of the application of that method, not all of the votes that are indicated on a beneficial owner's VIF will be cast as directed by that beneficial owner.

C. Vote Confirmation

Enabling beneficial owners and registered owners alike to confirm that their votes were timely submitted to, and accurately recorded by, the vote tabulator, is clearly a desirable regulatory objective. The critical question, once again, is at what cost? For example, imposing a system of direct voting by beneficial owners – in lieu of intermediaries voting pursuant to instructions from their beneficial owners -- could greatly facilitate the ability of shareholders to confirm that their shares were properly and timely voted. We believe that such a system, if implemented, should be applied to all shareholders – regardless of the manner in which they hold their shares. A review of comment letters submitted by various participants in the proxy voting process suggest that it might be possible for vote confirmation to be achieved with little additional cost to such participants. Vote confirmation also could be accomplished by moving to a system of unique identifier numbers for beneficial owners while preserving OBO status.

However, this approach would not provide the potential communication benefits that could be facilitated by modification to the current OBO/NOBO structure.

This observation, of course, stands in stark contrast to our previous discussion of over-voting and vote reconciliation methodologies, where we observed that a partial or total direct voting system would require significant changes to the current vote reconciliation system, because it would limit the ability of custodial intermediaries to engage in post-reconciliation and hybrid reconciliation methodologies. All of which is merely to state the obvious: due to the complexity of the proxy voting system, and its inter-relationship with a number of other desirable or necessary objectives, such as net clearing and the use of central depositories, facilitating shareholder choice in the way shares are held and honoring the economic interests of shareholders and custodial intermediaries, there almost certainly is no perfect proxy voting system. Leaving the proxy voting system relatively unchanged or modifying it in larger or smaller ways will need to be resolved in terms of relative cost-benefit analyses.

We do not have a view on the feasibility or costs of the Commission's suggested system of requiring all proxy participants to share voting data, but employing a unique identifying code to preserve an OBO's confidentiality deserves further study. If implemented, significant consideration should be given to whether this feature should be mandatory for all custodial intermediaries, or optional in that an intermediary would be permitted to elect to participate and then offer its customers the enhanced verification system as a value-added feature of the particular account arrangement. Those investors that place a value on the system would choose to hold their shares at intermediary firms that elect to participate, even if some of the additional costs are passed on to accountholders in the form of higher fees. Indeed, to the extent feasible and cost-effective from the intermediary's perspective, an intermediary should be permitted to offer participation in the system to only those beneficial owners willing to support it. As noted in the introduction to this letter, any regulatory framework adopted by the Commission will work best if it is consistent with the economic incentives to which the relevant participants are subject.

We have one further observation with respect to the Commission's inquiries concerning vote confirmation. While we agree that companies as well as investors have significant interests in the integrity and accuracy of the proxy voting system, if a system of direct voting is not adopted, we question the desirability or need to insert companies into the process by which intermediaries and their agents convert and then submit beneficial owners' voting instructions via omnibus proxies. On the other hand, if a system of direct voting is adopted, proxies would flow from beneficial owners directly to the tabulator, and the companies would have a direct connection with the tabulation and reflection of votes of beneficial owners. This analysis suggests to us that if vote confirmation is achieved otherwise than through direct voting, the company – of all the participants and interested parties – would have the least knowledge and would be the furthest removed from the logistical process resulting in the submission of VIFs and omnibus proxies. It therefore seems to us unwarranted, in this circumstance, to place on companies some or all of the regulatory burdens, expense and responsibilities for ensuring that beneficial owners' voting instructions are properly converted into proxies.

D. Proxy Voting by Institutional Securities Lenders

1. Lack of Notice of Meeting Agenda

This inquiry in the Concept Release begins by possibly conflating two distinct fact patterns. The Concept Release notes that some institutions have policies requiring the institution to recall all lent shares of an issuer in sufficient time to vote all of the shares at a shareholders' meeting. Institutions with such mandatory recall policies do not need advance notice of the matters to be voted on. So long as the notice of the setting of a record date for the meeting is provided in sufficient time to permit the recall of lent securities, the institution will be able to fulfill its policies by recalling all of the lent shares. Nor does the Concept Release suggest that the current rules regarding notice of the setting of record dates are inadequate to permit recalls of lent shares for institutions with the policy of recalling all lent shares.[8] As a consequence, this class of investor would seem unaffected by the timing of a company's public dissemination of the agenda for a shareholders' meeting.

The second fact pattern mentioned in the Concept Release relates to a different class of institutional share lender – one which will elect to recall lent shares only if there is an item on the agenda for a shareholders' meeting which, in its judgment, warrants recalling shares in order to vote on that specific agenda item. Although there may be occasional exceptions, we observe that merger and acquisition transactions, election contests (whether conventional or arising from proxy access) and virtually all significant corporate reorganizations are a matter of public record well before the notice of the setting of a record date. If those responsible for voting the lending institution's securities are paying attention to critical events occurring at portfolio companies, they will in fact have more than ample notice of the nature of the votes that will be held at the meeting sufficiently early to recall lent shares.

This leaves open two other types of vote at shareholders' meetings. One is the routine business matters that appear regularly on the meeting agenda. These typically consist of uncontested election of directors, ratification of auditors engaged by corporate audit committees, and say-on-pay advisory votes (and, less frequently, say-when-on-pay votes).[9] Since these

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8 We also note that special meetings require advance notice of record dates and that the agenda for special meetings is never a mystery. Again, share-lending institutions will know or could find out the agenda for a special meeting in time to recall lent shares without any difficulty.

9 Under the SEC's recent rule proposal relating to say-on-pay votes, companies will be required to disclose whether they follow a practice of conducting annual, biennial or triennial say-on-pay votes. Presumably it will not be difficult for institutions to establish a company's voting schedule for these votes. *See* Shareholder Approval of Executive Compensation and Golden Parachute Compensation, SEC Rel. Nos. 33-9153; 34-63124 (Oct. 18, 2010)("Say-on-Pay" Proposing Release").

voting matters are or can be known far in advance of the record date, share-lending institutions will have sufficient time to recall their lent shares if they want to vote on these routine issues.

Accordingly, we believe the only types of vote for which information to facilitate discretionary share recalls is actually desired fall into one of two principal categories: shareholder proposals under Rule 14a-8 and votes with respect to equity incentive compensation plans.[10] The appropriate inquiry, then, is the cost-benefit analysis of giving share-lending institutions the ability selectively to recall lent shares to vote on this relatively narrow group of proposals, or of allowing companies to retain the flexibility historically granted to them by state law and the SEC's proxy rules to refrain from announcing the agenda for a shareholders' meeting until the mailing of the definitive proxy materials.

At the end of the day, the economic cost on the corporate side for requiring earlier publication of a preliminary agenda should not be very high, so long as companies would retain the right to add matters to, or subtract matters from, their meeting agendas until distribution of their definitive proxy materials.[11] The asserted benefit on the share-lending institutional side, of course, would be an increased ability for institutions to recall lent shares selectively only when they felt there was a ballot item justifying a recall and thus minimize the loss of share-lending income during the period of the recall.

We question, however, whether this narrow view of the balance is appropriate. There are underlying and difficult policy issues in providing institutions with increased flexibility to lend and recall shares, not to mention the possible impact of greater utilization of selective recalls on theshare-lending market and ultimately the equity capital markets. Some of the more apparent underlying policy and systemic issues are:

- The compatibility of facilitating selective share recalls with the basic Federal policy enunciated on a number of occasions by both the Department of Labor ("DOL") as administrator of the Employee Retirement Income Security Act of 1974, and the Commission

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10 Another category of votes for which institutional investors arguably may wish to recall lent shares is "vote-no" campaigns. However, we believe most "vote-no" campaigns are not "launched" until later in the proxy solicitation process than the record date and thus would not be known prior to the record date. In the relatively few situations in which there is advance notice of a "vote-no" campaign, we believe that it would be akin to a proxy contest, and thus a matter of public record, well before any meeting agenda would be set.

11 We note that under most state corporation statutes a company retains the right to add or delete agenda items until the actual meeting. Deletions, in fact, are common in the context of proxy fights which are settled in the run-up to the meeting. Additions, while perhaps less common, are clearly contemplated under state law and the SEC's proxy rules by their provisions addressing granting discretionary voting authority to the holders of proxies.

as the supervisory agency for investment advisers, to the effect that votes are fund assets and the investment manager's fiduciary duty requires the adviser to vote all of the shares held in its portfolio on all matters. Selective share recalls seem directly at odds with this principle, in that facilitating such recalls encourages institutions to place a dollar value on votes, forgoing those votes (by not recalling lent shares) which a particular institution believes have insufficient economic value to offset the income potential of share-lending. Put another way, if under Commission and DOL fiduciary voting standards votes can properly be analyzed for their economic value in the share-lending context, why cannot an institution determine that, except in identified cases (for example mergers, sale of assets, control contests, director election contests), the cost to it of voting exceeds the economic value of the vote and therefore it better fulfills its fiduciary duty by eschewing votes on all matters that do not have clear economic value to its portfolio holdings? This would seem to be a rational economic justification for not voting most shares at least some of the time, and one that we believe could be justified under a fiduciary duty rubric. However, it seems to us to be at odds with our understanding of the Commission and DOL views about the fiduciary duty of investment advisers to vote portfolio shares 100% of the time.

- Another policy issue is the desirability of a Commission-mandated policy that allows (or encourages) certain institutions to engage in selective share-lending recalls. This policy determination arguably runs counter to what we believe to be a fundamental tenet of the proxy rules – that they should be neutral and not be designed to favor any particular constituency. Advance agenda publication would be geared solely to institutional investors that engage in an active share- lending program and, as a practical matter, would be unavailable to smaller institutions and other investors, retail or otherwise, that hold shares in conventional margin accounts and have no way of knowing how many votes they will in fact be able to cast at any given annual meeting nor an ability to recall shares lent by their custodians.

- Finally, if large, regular share-lending institutions actively take advantage of their ability to engage in selective share loan recalls, the result may be a far higher incidence than is now experienced in the share-lending markets of large share loan recalls during a relatively short period surrounding a record date for a shareholders' meeting. We do not have any views as to the potential for this type of market disruption, but suggest that the Commission seek and evaluate market-based data to ascertain whether an increase of share-loan recalls may have a negative effect on the share-loan market and on the broader equity capital markets which rely on large share-lending programs to provide liquidity and to facilitate short sales and other types of hedging opportunities.

2. Disclosure of Voting by Funds

The Concept Release notes that registered investment companies are required to file annually a Form N-PX indicating how the funds voted on every matter brought to a vote at shareholders' meetings of its portfolio companies.[12] The Release poses the question whether the Form N-PX should be revised to indicate how many shares were actually voted in that manner, thus providing some insight into the fund's share-lending activities.

Interestingly, the Concept Release does not identify a reason for requiring this additional information, nor do we think it would benefit investors in the fund to be provided with the information. First, unless the disclosure also included the total number of shares held by the adviser on the record date, knowing the number of shares voted would be relatively meaningless. Second, at best the disclosure would enable an investor to estimate the mutual fund adviser's share-lending position only as of a record date for a shareholder meeting. As such, we do not think the information would provide a basis for an investor to evaluate the fund's share-lending activities as whole, nor to understand the economic aspects of its share-lending policies in contrast to its voting policies.

We also observe that the required disclosure would be applicable only to one class of institutional investor, not all classes. Participants in company, public employee and union pension plans would not receive similar information about the share-lending posture of their fund as of a record date. The large world of institutional investing of private funds would not be subject to the proposed disclosure.[13]

E. Proxy Distribution Fees

The Committees do not have the knowledge or experience to deal with the specific issues raised in this section of the Concept Release. We do have one observation, however, on the fundamental policy level. We believe that history and economics have repeatedly demonstrated that, in general, a market open to all comers, with winners and losers determined by competition,

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12 We note that this relatively recent disclosure requirement seems to have been used by some corporate governance activists to pressure mutual fund managers to change their voting patterns or policies, or face an active campaign to dissuade investors from continuing to use those advisers. We find it ironic that at least some segments of the corporate governance community, which cut its teeth on shareholder proposals for mandatory confidential voting out of concern that company executives would try to pressure managers of other company defined-benefit plans to vote for or against certain shareholder proposals, have more recently espoused the elimination of confidential voting by mutual fund advisers so that pressure similarly can be brought to bear on such advisers to change their voting behavior and/or policies.

13 *Compare* Reporting of Proxy Votes on Executive Compensation and Other Matters, SEC Rel. Nos. 34-63123; IC-29463 (Oct. 18, 2010)(proposing that all Form 13F filers be required to disclose voting on the new Dodd-Frank executive compensation advisory provisions proposed in the Commission's Say-on-Pay Release, *supra* note 9).

produces superior services and/or lower fees than a market dominated by a single provider.[14] Although the market for the distribution of proxy materials, proxies and VIFS and for the collection and tabulation of VIFS and proxies may not be large enough to support vibrant competition, we believe it is the market that should make that determination, not regulatory policy. As a result, we support as a matter of wise policy a Commission regulatory system that fosters open markets in the proxy material distribution and vote collation processes.

II. Communications and Shareholder Participation

We share the Commission's goal of promoting broader shareholder participation in the proxy voting process – particularly on the part of retail or individual shareholders – through the removal of unnecessary regulatory and/or structural barriers to communication between companies (and other soliciting parties), on the one hand, and beneficial owners of street-name stock, on the other. Several possible regulatory approaches to achieving this goal are outlined in the Concept Release, ranging from limiting or eliminating OBO status and providing for direct voting by all beneficial owners, to incremental modifications aimed at streamlining and otherwise improving the current OBO/NOBO communications framework. All have some merit, and are worthy of careful cost-benefit analysis by the Commission pursuant to a formal study, further rulemaking, or some combination of the foregoing.

That being said, we believe that facilitating direct communication with beneficial as well as registered owners of voting equity, to the extent companies and other soliciting parties choose to engage in such communications, would be likely to foster innovative new practices and mechanisms designed to stimulate enhanced shareholder interest in participating in the proxy voting process. The layers of intermediation that have been so effective in streamlining clearance and settlement in a centralized national market system have come to impede, rather than to encourage, voting by the ultimate economic owners of corporate stock. For the past 30-odd years since the original OBO/NOBO communications mechanism was established by Commission rule to enfranchise beneficial owners of street-name stock, financial intermediaries have viewed proxy-related communication between these owners and issuers (and/or other soliciting parties) largely as a compliance function, preferably to be outsourced to unregulated agents.[15] Meanwhile, the costs of such functions have been shifted to public companies that have no means of evaluating the reasonableness of such costs and no ability otherwise to devise

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[14] We note in this regard the criticisms outlined in the Concept Release (at pages 56-58) of the troubling and potentially "unreasonable" expenses for which reimbursement now is sought under the New York Stock Exchange's proxy fee schedule, in the form of managed or wrap account fees, rebates paid to broker-dealer firms by a proxy service provider, and recurring paper suppression fees.

[15] As the Commission points out, some intermediaries may view the current proxy communications framework as affording an opportunity for profit, whether due to contractual arrangements with proxy service providers for so-called "rebates", or share-lending activities, or some combination thereof.

more cost-effective alternatives. Nor are the stock exchanges, which set fees for member broker-dealer firms' proxy-related services that have come by default to govern what non-member banks and other institutional custodians (or, more accurately, their agents) charge issuers, comfortable with their de facto role as arbiters of what constitutes a "reasonable" fee for each of these services.[16] This situation illustrates the potential issues we believe can arise when the regulatory framework imposes requirements on parties that do not have the corresponding economic incentives.

In the meantime, proxy statements have become more complex, abstruse and voluminous, making it even more difficult for shareholders to understand the issues being presented to a vote and summon the level of interest necessary to meaningful engagement in the voting process. Rigid proxy filing requirements and attendant liability exposure have tended to discourage companies and intermediaries alike from experimenting with more creative, Internet-based shareholder educational tools aimed at fostering such engagement. Use of the affirmative consent model for electronic delivery, last addressed by the Commission in 2000,[17] unnecessarily constrains an issuer's ability to harness the Internet as an effective medium for proxy-related communication. The Commission's more recent "notice-and-access" model has shown promise, but is not as efficient or cost-effective as it might be if the current communications regime were simplified through disintermediation of the proxy delivery and/or voting processes, and changes otherwise were made that could lower the costs and timing constraints of relying on that model.

A. Disintermediation of the Proxy Delivery and/or Voting Processes

The application of technological developments to proxy communications has evolved over many years. We anticipate that it may take several more years for the Commission to assess the current proxy system and adopt rules that will enhance confidence in the reliability and integrity of a reformed system that more effectively serves the needs of investors, companies and other proxy participants. The Commission may decide, quite reasonably in our view, to adopt an incremental approach to reform by allowing, but not requiring, greater disintermediation of the proxy delivery and voting processes. Recognizing that complete elimination of the OBO/NOBO distinction among beneficial owners of street-name stock may not be feasible in the near term, we urge the Commission to give careful consideration to eliminating OBO status around the record dates for shareholder action.[18] Such an approach (sometimes referred to as an "annual NOBO" or "ABO" concept) would enable companies to communicate directly with all of their

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16 *See, e.g.,* Comment Letter submitted by the New York Stock Exchange, NYSE Amex and NYSE Arca, Inc., on the Concept Release, dated October 20, 2010, at 3.

17 *See* Use of Electronic Media, SEC Rel. No. 33-7856; 34-42728; IC-24426 (April 28, 2000).

18 If OBO status were not eliminated entirely around record dates for shareholder action, there are intermediate steps that could discourage investors' invocation of OBO status, but we believe such intermediate measures are less preferable.

shareholders (whether registered or beneficial owners) solely for purposes of a shareholders' meeting (or consent solicitation), while minimizing the potential for misuse of share ownership information. In this regard, we recognize the need to take into account the privacy interests of investors. However, we believe that the strong policy interest in encouraging direct communications around shareholder votes weighs against permitting OBO status (which hampers such communications) at those times. Moreover, we believe that eliminating OBO status only at record dates for shareholder action should mitigate investor privacy concerns by ensuring that the information is available only infrequently and only as of a particular point in time. Further, whatever the current practice regarding NOBO lists,[19] the shareholder information required to implement this mechanism could be limited to the names of accountholders and means of contact (*e.g.*, the address, phone number and e-mail address, if available and perhaps subject to an appropriate consent regime, of the ultimate beneficial owner or its nominee, and even ranges of securities ownership, if feasible) without identification of individual or institutional accountholders' securities positions or the corresponding bank or broker-dealer custodian.

Moreover, based on the results of the 2006 New York Stock Exchange survey of retail investors and other data cited in the Concept Release, it would seem that those shareholders most concerned about preserving confidentiality vis-à-vis the issuer are institutions that would be better-equipped to bear the costs of opening and maintaining a nominee account with an intermediary. With respect to those retail holders who might choose to withhold their identities from issuers and other soliciting parties, whether pursuant to the creation of a nominee account (to maintain uninterrupted OBO status) or invocation of OBO status between proxy solicitations under an ABO scheme, we recommend that the Commission consider whether broker-dealers, banks and other institutional custodians should bear these costs, rather than imposing such costs on either the individual holders or the company (and hence all of its shareholders).[20]

If, as a further step, direct delivery of initial proxy materials to beneficial owners became permissible via Commission amendments to the proxy rules, some companies (depending of course on shareholder demographics) might explore the relative costs and benefits of direct proxy delivery to beneficial owners effectuated by their own agents, but otherwise might be inclined to continue to focus their informal shareholder communication practices primarily on the largest institutional and individual holders. Other companies may prefer the present system and continue to deliver proxy materials through intermediaries and their agents. Some of those other companies (and some others engaged in proxy soliciting activities), again depending on

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19 We understand that NOBO lists now identify beneficial owners' names, addresses and securities positions.

20 Any analysis of the appropriateness of cost-shifting should take into account whether individual street-name holders are fully and fairly informed of the consequences of maintaining OBO status for periods other than the annual or other shareholders' meeting (or solicitation of action by consent), and/or establishing a nominee account to maintain uninterrupted confidentiality of their identities.

demographics and the possibility of close votes, might in certain cases engage in other direct communications with and solicitations of shareholders.[21] We believe that companies (and, where applicable, other participants in the proxy process) should have these choices under the proxy rules, and not be compelled to engage in forms of communication that are not necessary or appropriate to their particular facts and circumstances. Some companies already have a strong need to reach out to a wide array of shareholders to "get out the vote"; for example, if they have a large number of smaller, retail shareholders (a phenomenon often associated, for example, with demutualized insurance companies), whereas others may not have sufficient incentive to use available means of direct communication except in specific circumstances.

Beyond distribution of proxy materials, the Commission could take the additional step of disintermediating the voting process itself. We believe the idea of direct voting by beneficial owners has considerable merit. Among other benefits, as discussed in Part I, direct voting by beneficial owners could offer potential accuracy and transparency improvements by facilitating vote confirmations. We therefore encourage the Commission to evaluate carefully the costs and benefits of enfranchising more directly those street-name holders that now are not given the opportunity to execute proxies.[22] To this end, the Commission should consider further the concept of a central data aggregator (whether a for-profit or non-profit entity) that would be responsible for compiling record date beneficial owner lists that do not permit linkage of DTC participants to individual beneficial owners. DTC, a registered clearing agency subject to fairly extensive SEC regulation and oversight, might be an ideal candidate for discharge of this responsibility – especially if the Commission's ongoing Direct Registration System ("DRS") initiative continues to evolve.

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21 We note that the Commission's Say-on-Pay Proposing Release provides that companies would not be able to rely on Rule 14a-8(i)(10) with respect to exclusion of certain shareholder proposals if their boards do not adopt a policy implementing the frequency vote supported by a plurality of voters. To the extent that the Commission's rules impose consequences associated with not implementing the results of plurality votes, the need for enhanced shareholder communications methods may increase.

22 As the Commission observed, Rule 14b-2 expressly authorizes banks and other fiduciaries to execute an omnibus proxy in favor of their accountholders. Whether or not they actually do so in practice is a question not addressed in the Concept Release. Although Rule 14b-1 prescribing broker-dealer obligations in the proxy context is silent on pass-through of the vote to customers, the Commission points out that nothing in the rule would prohibit such pass-through. Again, there is no discussion in the Concept Release of whether any broker-dealer has delegated proxy voting authority to its customers.

B. Constructive Means of Encouraging Greater Shareholder Participation in the Proxy Voting Process

We believe that the Commission's goal in evaluating specific proxy mechanics reforms should not be to increase retail voting percentages by any means, but rather to assess carefully the pros and cons of a wide variety of constructive approaches to motivating all shareholders – whether individuals or institutions – to exercise the proxy voting rights conferred by the federal proxy rules. As the Commission points out in the Concept Release, there is no single "magic bullet" or easy solution to the problems associated with the operation of the current, somewhat ad hoc proxy system that has developed in the United States, given the inevitable complexity and costs attendant to enfranchising a shareholder constituency that otherwise has no right to vote under applicable state corporate law. However, there are several constructive ideas we urge the Commission to examine in depth, whether pursuant to a proposing release, a formal study, or both.

There are at least two, relatively simple approaches the Commission could pursue immediately to promote greater shareholder understanding of, and interest in, the proxy voting process, regardless of what the agency decides ultimately to do about the existing OBO/NOBO communications framework: (1) allow broader use of "free-writing" by issuers and intermediaries to educate and inform all shareholders about how the proxy process works, why their individual votes are important, and how they can participate in the process; and (2) permit companies (and other parties conducting a non-exempt solicitation) more flexibility to present – and disseminate – material information in a clear, concise and meaningful way. Several suggestions for implementing each proposed approach are outlined below.

1. Expand the Scope of Permissible "Free-Writing" by Issuers and Intermediaries

We urge the Commission to consider removing existing regulatory obstacles to issuer-shareholder communication that we believe inhibit issuer efforts to educate and inform retail shareholders of the importance of the franchise and the value of their individual votes in the present environment. Prior Commission efforts to encourage issuer "free-writing" in furtherance of the goal of informed shareholder voting – including the "furnished" annual report to shareholders carrying lesser liability consequences and issuer educational materials relating to electronic notice-and-access – have not resulted in abuse or fraud to the best of our knowledge. The recent success of Prudential Financial, a demutualized insurance company with substantial individual share ownership in registered form, in stimulating increased voting through application of an innovative, "get-out-the-vote" technique that promoted voting regardless of the outcome, is instructive in this regard.[23]

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[23] Prudential Financial launched an "incentive program" in February 2010 designed to encourage shareholders to vote at the upcoming shareholders' meeting, in any manner they chose, by offering them "two premiums: A sustainably manufactured, reusable shopping tote or a tree planted in their name by American Forests, a well-known

The time has come, we believe, for the Commission to explore ways to revise the proxy rules in order to promote the use of neutral, educational materials by issuers and intermediaries intended to educate retail and other beneficial owners regarding both the significance and the means of exercising their voting rights, without reference to how those rights are or should be exercised. As the Commission previously recognized in adopting the recent amendments to Exchange Act Rule 14a-16,[24] there is a meaningful distinction between explanatory materials that merely inform shareholders, and "[m]aterials designed to persuade shareholders to vote in a particular manner or change the method of delivery of proxy materials …."[25] Companies that are willing to bear the cost of preparing and disseminating information that merely explains to shareholders – whether they hold directly, as in the case of Prudential, or in street name – should be given incentives to do so, in the form of a broad exemption from the definition of "solicitation" set forth in Exchange Act Rule 14a-1(l), or a modified exemption that would permit the distribution to beneficial (as well as registered) owners of educational "free-writing" that promotes voting but does not make any recommendation on how to vote. With respect to this modified exemption, which could be added to existing Exchange Act Rule 14a-2, the Commission could subject such materials to the antifraud provisions of Rule 14a-9 and/or require them to be "furnished" to the Commission in the same manner as the glossy annual report or posted in a dedicated section of the issuer's website. Such constructive measures could amplify the benefits of the Commission's own, commendable proxy education initiatives by de-mystifying and otherwise rendering the proxy process more accessible to retail shareholders.

Similarly, if the Commission elects to preserve the current OBO/NOBO distinction and the requirement to deliver initial proxy materials to beneficial owners through intermediaries, it should require intermediaries to pass value-neutral educational materials through to beneficial owners and recoup their "reasonable" expenses from the issuer.[26] In addition, broker-dealers and banks could do much more to make effective use of Internet-based customer accounts as a tool for communicating proxy-related information to customers, as the Commission suggests.

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nonprofit organization that restores indigenous plants to endangered forests throughout the world." Prudential Financial Press Release, dated June 3, 2010, "Prudential Financial's incentive program succeeds in encouraging shareholder voting", available at http://prudentialmedia.tekgroup.com/article_display.cfm?article_id=5728. According to this release, the company's "innovative approach to encourage proxy voting achieved its goal, helping the company record an increase of 23 percent in registered shareholder votes compared to 2009. In addition, 68,000 shareholders who did not participate in 2009 voted in Prudential's 2010 proxy process." *Id.*

[24] *See* Amendments to Rules Requiring Internet Availability of Proxy Materials, SEC Rel. Nos. 33-9108; 34-61560 (Feb. 22, 2010).

[25] *Id.* at text accompanying footnote 28.

[26] Note that the Commission declined to do so in connection with the February 2010 notice-and-access amendments.

Indeed, as the Commission points out, "many investors [now] use their brokers' Web sites as 'one-stop shopping' for their investment needs," and we see no reason why the same "information highway" could not be adapted by brokers and banks alike to "provide information about upcoming corporate actions or enable investors to use the same platform for proxy voting [assuming the Commission does not move forward with direct voting by beneficial owners]."[27] Both brokers and banks could use the account-opening process – whether or not it occurs online – to educate their customers on such matters that are highly relevant to the proxy voting process as the significance of the differences between choosing NOBO vs. OBO status. Such an obligation could be implemented via an amendment to Rule 14a-2(a)(1).

2. Streamline Content and Delivery of Proxy Disclosures

As noted above, proxy statement disclosures are frequently lengthy and dense, and may often be daunting to retail investors faced with numerous other demands on their time and attention. The Committees believe that the presentation of proxy materials could be improved to make them more accessible, without excessively burdening issuers. For example, layering of disclosure, with a summary directing readers to more extensive discussion in the body of the document, alone or in conjunction with greater use of hyperlinks, could enable shareholders to find relevant disclosures on a particular proposal more easily, and to understand those disclosures within the framework of the overall meeting agenda. Another idea we believe merits further Commission consideration is the use of a "summary proxy statement" approach modeled on the summary prospectus that registered investment companies may deliver in lieu of the full statutory prospectus, subject to specified conditions (including but not limited to the online availability of the statutory prospectus and its delivery in paper format upon request).[28]

We also believe that companies should be permitted to include a proxy card or VIF with the Notice of Internet Availability of Proxy Materials first sent to shareholders under the notice-and-access provisions of the proxy rules. While we recognize that this would separate the proxy card or VIF from the related disclosures, we believe online information availability at the time the Notice is disseminated is sufficient to enable investors to make informed decisions, by analogy to the model of online information availability that applies to investment decisions under the Securities Act of 1933, as amended.

3. Advance Voting Instructions

The Committees agree with the Commission that it is important to seek to promote greater voting participation among retail investors. The Commission has requested comment on whether advance voting instructions from retail holders might be an effective means of achieving this goal. We will not reiterate here the pros and cons of this concept, many of which are well-

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27 Concept Release at 80.

28 Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, SEC Rel. No. 33-8998 (Jan. 13, 2009).

documented in the Concept Release and addressed in detail by other commenters that participate directly in the proxy delivery and voting processes. We believe the concept is worthy of further Commission consideration as a tool that could increase retail investor participation, at least to the extent low retail investor voting levels reflect time constraints or difficulties navigating the voting process. We agree with the Commission, however, that advance voting instructions pose a number of issues, particularly insofar as the concept is in tension with the underlying principle of the proxy rules that disclosure must be made available before investors may be asked to vote. (Again, as we note above at page 6 of this letter, the key issue here is the availability to investors of full and fair disclosure on matters subject to a vote, not whether investors in fact understand and/or actually vote (or instruct their custodians to vote) on the basis of such disclosure. Instead, the Commission should focus on removing unnecessary regulatory or structural hurdles to voting by retail and institutional investors alike.) Given these challenges and the uncertainty regarding the potential costs and benefits of implementing advance voting instructions, we would not pursue changes based on advanced voting instructions to the exclusion of other possible changes discussed in this letter, which also could produce beneficial results and could be easier to implement.

C. Data-Tagging Proxy-Related Materials

In the Concept Release, the Commission solicits comment on extending eXtensible Business Reporting Language ("XBRL") data-tagging requirements to proxy-related materials. Although the Commission's interest in facilitating investors' use of company information is commendable, we believe that the substantial time and cost associated with data-tagging, coupled with the as-yet unproven value of providing proxy statement and voting information in an interactive format, militate against expanding companies' current XBRL obligations without substantially more study of reported difficulties and delays associated with data-tagging of financial statement information and of whether investors in fact perceive benefits from the current tagging requirements.[29]

We are aware that some issuers have expressed concern over higher than expected costs for converting financial statements and footnotes into XBRL format. Moreover, financial printers that carry out this conversion process have accelerated deadlines for issuers to submit their filings, due to the increased volume of tagging work. These timing problems would only be exacerbated if tagging of proxy-related information became compulsory, because of the proximity in filing deadlines for annual reports on Form 10-Ks and proxy statements, respectively.

We are doubtful that much, if any, proxy-related information is readily susceptible to data-tagging, a formatting technique designed primarily to facilitate quantitative analysis by end-users of financial statements. Granted, some of the prescribed executive compensation

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29 *See, e.g.*, Staff Observations from Review of Interactive Data Financial Statements (from November 1, 2010), available at http://www.sec.gov/spotlight/xbrl/staff-review-observations-110110.shtml.

disclosure contains information to which the standardized data taxonomy may be applied. Because companies are not bound by any commonly accepted methodologies or formulas in determining incentive compensation, however, meaningful quantitative compensation comparisons among companies are unlikely. In any case, much of the proxy statement involves a narrative explanation of the numbers presented in the various tables – without that context, the raw numbers alone are potentially misleading (the Commission's own rationale for requiring a CD&A and encouraging narrative discussions of tabular information).

We recognize that certain institutional investors advocate the extension of XBRL requirements to proxy statements. In the final analysis, however, the Commission should not take this step unless and until it conducts the necessary cost-benefit analysis to determine whether the increased costs and other burdens of imposing additional XBRL obligations on public companies are outweighed by the utility of the interactive data thus produced to a broad cross-section of shareholders – including most prominently the retail segment. As discussed above, we believe that streamlining the presentation of key proxy information will be of much greater utility to retail shareholders and others that already find it difficult to digest the information contained in the voluminous proxy statements and annual reports that they now receive in connection with annual meetings of shareholders.

Should the Commission nevertheless decide to pursue the extension of XBRL to proxy statements, we strongly recommend that it begin with a pilot program comprised of those companies that believe their shareholders might find an interactive data format to be useful to understanding proxy-related information, and are willing to undertake the costs of testing that proposition. Further, we suggest that the Commission engage an independent third party to conduct a survey (which is now permissible in light of Dodd-Frank's modification of the Paperwork Reduction Act requirements[30]) of a large sample of retail, as well as institutional, shareholders to gauge their interest in and ability to use proxy-related XBRL data.

III. Relationship between Voting Power and Economic Interest

A. General Considerations

Historically, the default governance structure for U.S. public companies has been that owners of the enterprise at the record date have had the corresponding voting power. While this principle continues to underlie our corporate governance model, it has been put into doubt to some extent by several recent developments. As a result of short selling or expanded use of derivatives, investors can eliminate or alter the nature of their ownership while retaining voting power, and can accumulate voting power without corresponding economic indicia of ownership. The right to vote can be shifted through share-lending, by design or inadvertently. In addition, share transfers between the record date and the meeting date may result in separation of ownership from voting power.

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30 Section 912 of the Dodd-Frank Act, *Clarification of Authority of the Commission To Engage in Investor Testing*.

External factors also affect the alignment of ownership and voting. The influence of proxy advisory firms, most notably ISS, with no disclosed ownership interest in corporate voting stock, but with impact upon voting outcomes through their recommendations that may be significant, has led to exercise of the shareholder franchise without voting decisions in fact being made by owners. Institutional investors, particularly those without internal voting analysis capabilities (which are often smaller and have less infrastructure), routinely delegate at least certain aspects of voting decision making to third parties. The influence of these institutions on voting results has expanded as share ownership has shifted from individual owners to institutions, and as retail investor voting has declined. Even in institutions that have not outsourced voting decisions, or have done so only in limited ways, the voting decisions frequently are divorced from investment decisions because of the internal separation of decision making in these two different areas.

In these circumstances, the natural questions are what, if anything, can and should be done to restore the alignment between economic ownership and voting, and what disclosure should be required both to assess the scope of the problem and inform companies and their investors of the nature and extent of departures from the anticipated norm (*i.e.*, alignment of economic interest and voting power relating to corporate common stock).

B. Voting Decision Making and Role of Proxy Advisory Firms

1. Proxy Advisory Firms

The past 50 years have seen an important transformation in the average shareholder base for most U.S. companies. In the 1950s, institutional investors owned less than ten percent of the stock of public companies in this country; today, their representation is closer to 70% of outstanding shares. At the same time, as noted by the Commission in the Concept Release, institutional investors have “substantially increased their use of proxy advisory firms.” The influence of proxy advisory firms in corporate elections has expanded significantly, but the Commission to date has not undertaken any meaningful oversight of those firms. We are pleased that the Commission is now taking a fresh look at these issues.

As we noted above, the Committees consider the promotion of “accuracy and transparency in the proxy and voting process,” along with objectivity and freedom from conflicts of interest, to be a critical goal for the Commission’s review of proxy matters as laid out in the Concept Release. We also believe that the Commission can find a significant opportunity to advance these goals through a careful evaluation of the role and regulation of proxy advisory firms. To the extent that a perception exists among some issuers and investors that the current proxy system lacks transparency, proxy advisory firms would seem to account for a meaningful portion of that situation. With these concerns and goals as our backdrop, the Committees believe that the thoughtful discussion and questions related to proxy advisory firms and their impact on the proxy landscape of public companies, as set forth in Section V.A. of the Concept Release, are appropriate starting points for consideration of possible regulatory approaches.

We highlight below some areas where the current framework for proxy advisory firms, their voting recommendations and their other activities fall short in promoting transparency, as well as the other important objectives of accuracy and objectivity, and we lay out some suggestions, involving both disclosure and regulatory approaches, for the Commission to consider in this regard as it moves forward.

2. The Importance of Transparency

As an initial matter, we note that the Commission asks a number of factual questions about the operations of proxy advisory firms, the other work they perform for their clients, the policies and procedures, if any, that they follow with regard to their voting recommendations and the competitive structure of their market. These are all appropriate questions, and we applaud the Commission for seeking their answers. That the Commission and the public cannot easily and definitively answer these questions points to a fundamental lack of transparency in this area.

The Committees recommend that the Commission consider requiring significantly expanded public disclosures from the proxy advisory firms directly, so as to further promote transparency for the benefit of the investors that are clients of the proxy advisory firms, the companies that are the subject of their reports and the public more generally. With regard to enhanced disclosure, we note a fundamental difference between *public* disclosure, which can inform the markets generally, and *private* disclosure to proxy advisory firm clients.

In our opinion, public disclosure by proxy advisory firms should include, at a minimum:

- *The various services performed by the proxy advisory firm, including voting recommendations, vote execution, administrative services, and research and analysis of public companies and corporate issues.* Proxy advisory firms should make clear both what services they provide and to which institutions they have provided those services. To avoid meaningless boilerplate, the Commission might consider a format that requires tabular disclosure as well as a discussion and analysis of the relevant information.

- *The objectives the proxy advisory firm seeks to achieve through making its recommendations and the relationship between the objectives and given recommendations*. As discussed in the introduction to this letter, we do not believe regulation should limit or define the permissible objectives of advice regarding proxy voting choices. That said, greater transparency regarding proxy advisory firms' objectives, and the ways in which recommendations are expected to further those objectives, is needed so that investors can determine, on a fully informed basis, whether to follow the advice. Only through such informed decisions can investors that follow proxy access firm recommendations maintain the desired alignment between their voting behavior and their economic interests.[31]

- *The proxy advisory firm's voting recommendations and any responses the advisory firm had received from the subject companies.* The timing of this disclosure, if made public, would obviously be important. We understand and appreciate that proxy advisory firms make money by providing these recommendations to paying customers in advance of corporate elections, and we do not mean to undermine that business model. We do believe that proxy advisory firms could make this information publicly available soon after the relevant shareholder action, and the public availability of this information would provide a service to investors and others that would use it for purposes beyond casting votes on specific matters.

- *The controls the proxy advisory firm has in place with regard to its execution of votes, and any failures it has experienced in vote execution or tabulation.*

- *The procedures the proxy advisory firm follows to ensure the accuracy of its assessments and recommendations, including the interaction it has with companies and the process followed to respond to company input.*

- *The monitoring processes, if any, used to test whether and to what extent the proxy advisor's recommendations in fact achieve the firm's stated objectives over time.*

- *Detailed disclosure and discussion of any conflicts of interest that the proxy advisory firm may have.* Although we do not claim to be able to identify every potential conflict of interest present for proxy advisory firms, we would think that at a minimum, firms should publicly disclose the extent to which they have received compensation from the public companies about which they provide advice and voting recommendations to their investor clients, as well as whether they themselves own (or have owned in the past year) any of the securities of those public companies. In addition, proxy advisory firms should disclose whether they are making recommendations with respect to specific shareholder proposals submitted by their clients. We believe it is important that this disclosure be made publicly available on a relatively current basis.

In the case of proxy contests (including any director elections for which shareholders have put forth nominees pursuant to the Commission's recently adopted Rule 14a-

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[31] *See, e.g.,* Choi, Fisch & Kahan, "Director Elections and the Role of Proxy Advisors", SSRN @http.//ssm.com/abstract=1225963. Indeed, in the absence of a clear explanation of the proxy advisory firm's objectives for its voting recommendations it is difficult to see how the institutional investor clients can discharge their fiduciary duties with regard to share voting because they lack a basis for relating the vote recommendation to an objective or policy to be achieved. *See* Part III.B.4 below.

> 11), the minimum required disclosure should include information about any fees received by the firm from any interested parties to the proxy contest, including the aggregate amount of and reasons for the fees. The disclosure should also include any other relationships between the firm and these other parties. The Commission would need to consider who should be included as "interested parties" for purposes of this disclosure (for example, other shareholders or beneficial owners above a specified threshold).

Although some commenters have called for enhanced disclosure in conjunction with any voting recommendations made by the proxy advisory firm, and we support that notion as a starting point, we believe that disclosures available only to a firm's clients or paid subscribers are insufficient. We would prefer to see the Commission require this type of disclosure to be publicly available, through the Commission's website or other freely available website. We recognize that the Commission does not currently have a regulatory system in place to require this type of public reporting by proxy advisory firms, but we would encourage the Commission to develop a framework that would provide for such disclosure, which we think the Commission could do under its existing authority. This disclosure might be accomplished, for example, through mandatory registration of proxy advisory firms under the Investment Advisers Act of 1940 (the "Advisers Act"), discussed in more detail below, and then with specific rule changes to mandate certain disclosure or a version of Form ADV under that regulatory umbrella. At the very least, the Commission would require relevant disclosures to clients of proxy advisory firms to promote these transparency objectives.

Proxy advisory firms could also be regulated under the proxy rules on the basis that they are engaged in proxy solicitation activities by virtue of making recommendations on how shareholders should vote. This could be done by revising the exemption under Exchange Act Rule 14a-2(b)(3) to address the specific circumstances of proxy advisory firms in order to achieve the policy objectives identified above. For example, the exemption could be conditioned to require the disclosure referred to above relating to transparency, accuracy and objectivity with respect to the particular matters that are the subject of the proxy solicitation.

By utilizing both the Advisers Act and the proxy rules, the Commission could accomplish both general disclosures regarding policies, procedures and activities of proxy advisory firms and particularized disclosure with respect to specific recommendations.

In addition, the Commission should make clear that the antifraud rules of the federal securities law apply to the activities of proxy advisory firms just as they do to the activities of credit rating agencies. This is an important added governor on the proper conduct of proxy advisory firms.

3. Regulation When Transparency Is Not Enough

As Chairman Mary Schapiro noted in the context of proxy access, sometimes transparency alone cannot fully achieve a desired goal.[32] As many commenters have noted, the proxy advisory firms can wield extensive influence over corporate elections and shareholder votes, and yet the firms themselves do not have a dog in that hunt— they generally have no economic interest in the companies and owe no fiduciary duties to the company's shareholders.

The most obvious and simplest route to more regulatory oversight of proxy advisory firms is through mandatory registration of all such firms under the Advisers Act. As the Commission notes in the Concept Release, proxy advisory firms provide services that correspond to those adviser activities that the Advisers Act is designed to regulate. Today, proxy advisory firms escape such regulation – if they do – only because they do not technically meet the threshold of having at least $25 million in assets "under management". The Committees believe that the sound and prudential policy considerations – including an effort not to burden small enterprises with excessive regulation, which is a goal the Committees especially applaud – that underlie this threshold do not apply to most proxy advisory firms. Proxy advisory firms may have no assets "under management" while at the same time receiving fees from, and in many cases essentially determining the votes for, investment managers representing large multiples of $25 million in assets. By squaring Advisers Act registration (and corresponding regulation) more precisely with the matters at hand, the Commission can both uphold those policy judgments and instill more structure and order into the oversight of the proxy advisory industry. For example, the Commission could continue to apply the $25 million assets threshold but provide an exemption from registration only for firms that neither have that amount of assets directly under management nor under management at other entities that in turn pay for the proxy advisory firms' advice or services. Alternatively, the Commission could consider defining assets under management, for purposes of the registration threshold, as including assets as to which voting advice or recommendations are provided.

We find interesting and illuminating the analogies the Commission and others have drawn between the regulation of nationally recognized statistical rating organizations (or credit rating agencies) and proxy advisory firms. We believe there are similarities in the concerns over the activities of proxy advisory firms and those expressed about credit rating agencies. While the same regulatory approach may not be necessary or appropriate, lessons drawn from the regulation of credit rating agencies to address the concerns that are similar can appropriately be applied to regulation of proxy advisory firms, utilizing existing Commission authority.

Further to its consideration of the appropriate regulatory treatment of proxy advisory firms, in addition to seeking comments through the Concept Release, the Commission might be

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32 *See* Remarks of Mary Schapiro, Chairman, U.S. Securities and Exchange Commission, Address to the Practising Law Institute's 41st Annual Institute on Securities Regulation (New York, New York, Nov. 4, 2009), available at http://www.sec.gov/news/speech/2009/spch110409mls.htm.

well-advised to undertake a study to develop a factual and policy record about the work of proxy advisory firms on a systematic basis.[33] We believe that beyond subjecting proxy advisory firms to greater regulation under the Advisers Act and the proxy rules, the Commission should take a careful and deliberative look at these questions with an eye toward determining whether it would be appropriate to develop an additional regulatory structure for the supervision of, and disclosure by, proxy advisory firms. In this regard, we support the New York Stock Exchange Commission on Corporate Governance's recommendation that the "the SEC should engage in a study of the role of proxy advisory firms to determine their potential impact on, among other things, corporate governance and behavior and consider whether or not further regulation of these firms is appropriate."[34]

4. Fiduciary Duty Concerns

Our understanding is that both the Commission under the Advisers Act and the DOL under the Employee Retirement Income Security Act of 1974 have effectively taken the position that investment advisers and retirement fund fiduciaries, respectively, have a fiduciary duty to their respective investors and plan participants with respect to the voting of portfolio company shares on all matters coming before shareholders of those companies. As noted above, some institutional investors have elected to discharge their fiduciary duties with respect to voting their portfolio shares entirely through internal processes. However, a large number of institutional investors have retained proxy advisory firms as their agent to discharge some or all of their fiduciary duties with respect to voting portfolio shares. We believe that, for the retention to be effective as a means of the institutional investor principal fulfilling its fiduciary duties, the proxy advisory firm must then discharge its responsibilities according to the same standards that would be applicable to its principal, or must clearly delimit the extent of the delegation or agency, in which event the institutional investor might not be able to rely merely on the delegation of these duties to a proxy advisory firm without breaching its own fiduciary duties.

This analysis, we believe, makes clear that the activities of the proxy advisory firms with respect to all aspects of their services on behalf of their principals should be subject to the same fiduciary duties of care and loyalty that pertain to their principals under the Advisers Act or other applicable law. We believe the Commission should recognize the fiduciary relationship between

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33 To our knowledge, the most recent study in this area was completed by the Government Accountability Office over three years ago. Even if this study's findings were current, however, the study itself did not address all the questions appropriately posed by the Commission in the Concept Release. *See* GAO Report to Congress, Corporate Shareholder Meetings—Issues Relating to Firms That Advise Institutional Investors on Proxy Voting (June 2007), available at http://www.gao.gov/new.items/d07765.pdf. *See also* S. Choi, J. Fisch, and M. Kahan, The Power of Proxy Advisors: Myth or Reality?, 59 Emory L.J. 869 (2010).

34 *See* Report of the New York Stock Exchange Commission on Corporate Governance (Sept. 23, 2010), at 8, available at http://www.nyse.com/pdfs/CCGReport.pdf.

proxy advisory firms and their principals that are investment advisers, and should consider formalizing that recognition in an appropriate rule or interpretation. This fiduciary relationship further supports the appropriateness of the Commission regulating proxy advisory firms through registration under the Advisers Act.[35]

Viewing proxy advisory firms as agents of fiduciaries, with their own fiduciary responsibilities in situations where substantive voting decisionmaking has been formally or informally "outsourced" by the fiduciary-principals (which we believe should be the case), supports our suggestions above for regulating the conduct of proxy advisory firms in a number of ways. As significant, we believe that this view also raises the important question whether and to what degree proxy advisory firms, in rendering their advice and recommendations on voting proxies, appropriately can rely on a one-size-fits-all model that ignores different facts and circumstances at the thousands of public companies that comprise the portfolios of their many clients. In the absence of reviewing governance and other proposals in the context of each company, it is uncertain that the advice or recommendation is as satisfactory as one that fully reflects all of the facts and circumstances. In these circumstances, at least in the absence of clear disclaimers and disclosure by proxy advisory firms as to the level of service they are providing and not providing, and as to the services their principals are receiving and not receiving, the degree to which proxy advisory firms can rely on a one-size-fits-all governance model in discharging a fiduciary duty of care seems questionable. On the other hand, if such disclosure or disclaimer is made, the degree to which the principal can rely, principally or exclusively, on the proxy advisory firm in discharging the principal's fiduciary duty seems questionable.

We do not underestimate the challenge of making a truly case-by-case determination as to the applicability of any voting policy to a particular company. To do so requires time and understanding of the management structure, operations and business of the company and, in all likelihood, concomitantly greater cost. However, ignoring company particulars because it is too costly to analyze them would appear to jeopardize both investors and companies. The linchpin of fiduciary duty is loyalty to the ultimate principal – the investor which entrusted funds to the money manager, or the plan participant in a pension or retirement fund, to whom the fiduciary duty is owed. It is no answer for the fiduciary to explain its conduct by citing the cost involved to act with due care.

In light of these fiduciary duty concerns, we recommend that the Commission make clear how a voting policy should be evaluated against an investment adviser's or advisory firm's fiduciary duty and whether and how, in its view, a one-size-fits-all voting policy discharges the fiduciary duty to vote imposed on investment advisers. As noted above, recognizing the economic reality of costs to provide tailored voting advice or services and investor valuation of

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35 We note in this regard that on October 21, 2010, the DOL's Employee Benefits Security Administration announced a proposed rule updating the definition of "fiduciary" under ERISA that would, among other things, make proxy advisory services plan fiduciaries. The proposed rule is available at http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=24328.

(and willingness to pay for) those services could lead the Commission to revisit the appropriate contours of requirements regarding whether advisers must vote in all circumstances in the discharge of their fiduciary duties and how their votes are determined.[36]

C. Empty Voting and Related Decoupling Considerations

We urge the Commission to follow two fundamental principles in addressing concerns over empty voting and other decoupling arrangements at this time: (1) increased transparency through expanded disclosure; and (2) leaving open the avenues to state law solutions, including those made available through private ordering, primarily by removal of Commission and stock exchange regulatory impediments to the extent that this can be done without sacrificing essential investor protections.

1. Disclosure Requirements

Empty voting and related decoupling of stock ownership and voting power appears to be a recent phenomenon, and we do not believe that there is a sufficient base of information to determine the exact scope and nature of this phenomenon and the significance of its impact. Therefore, before more intrusive regulatory action is taken, it would be advisable to obtain more information by expanding disclosure requirements with respect to these interests. Although this expanded disclosure might naturally be explored as part of the Commission Staff's 13D/13G rulemaking project dealing with the concept of "beneficial ownership" reporting, we believe there are at least two reasons why this effort should be undertaken separately from that project. First, the 13D/13G project is likely to take some time, and there is no reason to delay gathering information and providing greater transparency for companies and investors in the proxy voting area by waiting for that project. Also, as the rules are currently constructed, the concept of "beneficial ownership" serves multiple purposes that include disclosure under Exchange Act Sections 13(d) and (g), and disclosure and accompanying short-swing profits liability under

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[36] As we noted above in Section I.D.1 of this letter, the notion that an investment adviser's fiduciary duty requires it to vote all portfolio shares on all matters is in direct tension with the reality that many institutional investors engage in large share-lending programs which have the effect of trading the right to vote for revenues generated by share-lending. Additionally, the cost of voting all share on all matters on a case-by-case basis may well prove unsustainable from an economic point of view. *See*, *e.g.*, Comment Letter from Comm. on Fed. Reg. of Sec., Section of Bus. Law, American Bar Association, to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Nov. 22, 2010), at 23, available in Comment File No. S7-30-10 (relating to Reporting of Votes on Executive Compensation and Other Matters, SEC Rel. No. 34-63123; IC-29463 (Oct. 18, 2010). These considerations suggest, if they do not compel, a restatement of a registered adviser's fiduciary duty with respect to proxy voting. Perhaps a more appropriate standard (conceptually and economically) would be to the effect that a registered adviser has a fiduciary duty to consider whether and how to vote shares of portfolio companies, not an obligation to vote them.

Exchange Act Sections 16(a) and (b). It is not clear, especially in the absence of more detailed information, how various techniques associated with empty voting and decoupling should apply in respect of these other provisions, including in particular the Section 16(b) short-swing profits liability provisions and Section 13(g) "short-form" disclosure. For example, the effect that subjecting these techniques to Section 16(b) liability or Section 13(g) disclosure might have on existing market practices and trading strategies is uncertain, and could lead to unintended consequences.

Instead, we recommend that, at least for now, the Commission establish disclosure requirements to elicit information about empty voting and other decoupling arrangements apart from its consideration of the definition of beneficial ownership, in circumstances where those disclosures would be important to companies and investors. An advantage of this approach is that the disclosure requirements would not have to be limited to the 5% beneficial ownership threshold required by Exchange Act Section 13(d).

One place where the Commission should require disclosure relating to empty voting and other decoupling arrangements is in connection with proxy solicitations, so that investors have better information regarding the full interests of those engaged in the solicitation. This should include disclosures in connection with all proxy contests, including traditional election contests and nominations pursuant to Rule 14a-11 or any other access regime adopted by a company, whether pursuant to a Rule 14a-8 proposal or otherwise. There may be other circumstances in which this type of disclosure should be required that may become apparent based on a fuller review. The Commission could consider the proper treatment of these arrangements for purposes of the definition of "beneficial ownership" at a later time with the benefit of additional information obtained from the disclosures we suggest.

2. Role of State Law

State law and private ordering under enabling provisions of state corporation statutes might play an important role in addressing issues presented by empty voting and related decoupling arrangements. Accordingly, we believe it is important that the Commission eliminate any impediments that would constrain state law and private ordering efforts to the extent that may be done consistent with essential investor protection interests.

One example is the effort under state law to give corporations the flexibility to separate the record date for notice of meetings and the record date for determining who is entitled to vote at the meeting. Delaware has amended its corporation statute to allow this and the ABA Corporate Laws Committee has similarly amended the Model Business Corporation Act. By moving the voting record date closer to the meeting date, a corporation can reduce the potential for misalignment of voting and ownership that comes from transfers subsequent to the record date. As noted in the Concept Release, existing Commission rules and stock exchange requirements present roadblocks for public companies to use this flexibility. We believe the Commission, along with the stock exchanges, should make the changes necessary to allow this state law flexibility to be utilized. The Concept Release identifies the areas in which changes are necessary and we will not repeat them here.

We believe this goal of preserving flexibility under state law to address empty voting and other decoupling arrangements – the importance of which the Commission has recognized with respect to the allocation of voting rights and the conduct of shareholder meetings, to name just two examples – can be accommodated without impairment of investor protection. In particular, we believe that investor and market access to proxy information made available electronically should provide the Commission with the tools needed to craft a conceptual framework and starting point for such regulatory accommodation. Thus, proxy material made available to shareholders as of the record date for notice of the meeting should be considered sufficient to satisfy proxy informational requirements, because it would be readily available to those who subsequently become shareholders and entitled to vote. The guiding principle should be the availability and accessibility of current information, and not verification that it actually has been received and read.

In response to the specific question posed by the Commission, we believe that these changes should be made without waiting for demonstration that companies will make use of this flexibility. One thing that is clear – companies are unlikely to incur the delay, uncertainty and other costs attendant to weaving their way through existing regulatory constraints, with case-by-case negotiation with the Commission's staff, in order to utilize the new dual-record date technique. Also, while existing logistical issues reduce the practical ability to benefit fully from this flexibility, improvements in the future could make utilizing the authority to bifurcate record dates more desirable. These improvements are unlikely to be made if the limitations imposed by the existing regulatory scheme remain in place. Moreover, in our judgment, the Commission should have as a high priority accommodating state law approaches to corporate governance matters where otherwise consistent with the investor protection goals of the federal proxy rules.

Another example where Commission and stock exchange action would be desirable in order to allow use of state law flexibility for private ordering to address concerns over empty voting and decoupling is targeted modification of Rule 19c-4 and the related stock exchange rules that prohibit reducing or restricting voting rights of shares – not to allow the restoration of dual-class voting shares or other abusive techniques that led to the adoption of Rule 19c-4, but rather to facilitate action designed to achieve alignment of voting power and economic interests related to corporate stock where otherwise consistent with applicable state law. Thus, for example, a corporation and its shareholders might conclude that it is in their interests to adopt time-weighted voting, or to provide voting rights based on net long positions to align voting power with true economic interest, or to deny voting rights to any holder with a net short position. Existing Commission and stock exchange rules now prevent this type of private ordering to address concerns over the separation of voting power from economic interest, even if permissible under state law. While these broad federal regulatory limitations might have been justified in the past, their justification today in view of all the new instruments and techniques available to investors is, assuming full and adequate disclosure and the preservation of the general "one-share, one-vote" principle, somewhat questionable. We urge the Commission to re-examine the underlying reasons for these federal limitations in light of the new environment and to recognize the benefits of reasonable, state-enabled solutions in this area.

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The Committees appreciate the opportunity to comment on the Concept Release and respectfully request that the Commission consider the recommendations set forth above. We are prepared to meet and discuss these matters with the Commission and the Staff and to respond to any questions.

Very truly yours,

/s/ Jeffrey W. Rubin
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