CFA INSTITUTE
Centre for Financial Market Integrity

August 12, 2005

E. Norman Veasy
Chair
Committee on Corporate Laws
American Bar Association
1201 N. Market Street
Suite 1402
Wilmington, Delaware 19801

Re: Discussion Paper on Voting by Shareowners for the Election of Directors

Dear Mr. Veasy:

The CFA Institute Centre for Financial Market Integrity[1] ("The Centre") appreciates the opportunity to comment on the discussion paper released in June of 2005 by the Committee on Corporate Laws ("The Committee"). The Centre, through the experience in international markets and different investment disciplines of its 78,000 members in 119 countries, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis, investment management, and the efficiency of global financial markets.

The Centre appreciates the work that the Committee has undertaken to further the ability of shareowners to exert their rightful influence as the ultimate owners of U.S. corporations. The ability to exercise these rights is an element of the Centre's core belief that the interests of investors are preeminent.

The Centre supports a majority voting standard for directors in order to require full accountability of directors, and calls on nominating committees to act in good faith in proposing suitable board candidates. The Centre supports a majority voting standard in the election of directors because such a plan gives shareowners a reasonable amount of influence in electing board members who will act as their representatives to the company. The Centre believes that such a standard increases director accountability without altering their responsibilities as board members.

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[1] With headquarters in Charlottesville, VA and regional offices in New York, Hong Kong and London, CFA Institute (formerly, the Association for Investment Management and Research®) is a non-profit professional association of 78,000 financial analysts, portfolio managers, and other investment professionals in 119 countries of which 63,000 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 132 Member Societies and Chapters in 52 countries and territories.
The CFA Centre develops, promulgates, and maintains the highest ethical standards for the investment community including the CFA Institute *Code of Ethics and Standards of Professional Conduct*.

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Furthermore, such a straightforward majority voting standard would differ from the SEC's recent proxy access plan, which met with resistance from some business groups and investors. In part, the SEC's plan was criticized for its perceived complexity, delayed implementation (it could take years for shareowners to get a director on the ballot), and the ambiguity concerning penalties for non-compliance.

Discussion of Potential Problems

The debate relating to a majority vote standard has engendered several concerns from potentially affected parties. The Centre would like to speak to some of these concerns, in hopes such input will aid the Committee in their deliberations.

1. What if a director does not receive 50% of the vote?

A process must be set to deal with any directors that fail to reach the 50% threshold if that is the requirement under a new rule. The Centre supports the Committee's proposal to set a 90-day window for finding a replacement should any board member receive a majority AGAINST vote. However, the Centre also suggests that the Committee recommend that the company hold a special meeting to elect an alternative person to fill the seat rather than letting the board choose someone it wishes to fill that seat. Otherwise the default approach could create a situation wherein a group of board members nominates someone they believe shareowners will reject so as to enable them to replace that nominee with their own choice without shareowner approval. Because a lack of majority support has been such an uncommon occurrence, and investors will often make their dissatisfaction known well before the director slate is voted upon, a high level of investor dissatisfaction will rarely be an unexpected event. It is reasonable to expect that prudent companies will develop a list of contingency directors and hold a special meeting to elect an alternate nominee within 90 days.

The Centre expects that corporate issuers and their shareowners will often work together to avoid a situation in which the election of a director is at risk, particularly if any failed nominations would trigger a special meeting within 90 days of the original vote. Such a situation would most often send negative signals to the market, which would in most cases harm both parties – giving both sides an incentive to find a solution before a contentious majority vote battle ensues.

2. Minority shareowner influence.

Some parties have objected to a standard of majority voting for directors on the grounds that such a standard gives minority shareowners the ability to exercise too much influence over board elections. Under a majority voting standard, however, no minority shareowner would have the power to oust an individual director, unless they convinced a majority of shareowners to support their position. The very definition of a "majority vote" standard therefore protects against a minority shareowner unduly influencing a board election.

3. A majority voting standard may increase the complexity of the election system.

Opponents of the majority voting standard have raised the same argument used to oppose the SEC's proxy access plan; namely that such a standard would jeopardize the simplicity, certainty and efficiency of the current plurality voting system. To the contrary, we believe a majority voting standard is the model of efficiency and simplicity, and one that decides most of the other proposals voted on by shareholders.

The majority standard is in fact, the predominant rule across the global corporate world. Only in the U.S and Canada does the plurality voting system rule. Opponents of a majority vote rule for directors may have other concerns with corporate governance around the world, but they would be hard pressed to establish majority-voting as creating confusion and chaos in board elections outside North America.

4. Proxy advisory firm's current policies are not attuned to majority voting.

Proxy advisory firms and governance rating services can easily adjust to a world in which majority voting for directors is the rule. Most already operate in majority vote jurisdictions. Moreover, most proxy advisory firms have already voiced support for a majority approach.

5. A majority rule would make potential directors unwilling to serve.

The position of corporate director demands a great deal of time, effort, and attention and is not taken lightly by most who serve on corporate boards. The Centre expects that liability concerns account for most of the reticence of potential directors and doubts that a majority vote rule would deter qualified directors from serving on boards.

In any case, directors should take great care in deciding whether to join a board of directors. If a director does not believe they can devote the effort and attention to serve on a company's board or that their services would not help that company create value for shareowners then they should not accept a nomination.

6. What if a CEO is not elected, resulting in a breach of contract or other contract related event?

It is conceivable that a company's CEO would not receive the votes needed to remain a member of the board. The CFA Centre does not believe that such removal from the board could result in a breach of a CEO's contract that stipulates that the CEO must be a member of the board. No board should be legally bound to a promise that is ultimately contingent upon a vote of shareholders. Only shareholders are legally able to elect a director. The board could offer the promise of board nomination to any member of management, but actual election is the strict purview of a company's shareholders.

7. A certain percentage of the board, or the entire board could fail to get elected, triggering a change in control, or other unforeseen corporate event.

The Centre believes the probability of such an event to be extremely low – although companies may need to revisit their Charters and Bylaws or other "change–of-control" contracts to put procedures in place to deal with such a possibility, no matter how improbable.

If a majority vote rule is adopted, a company should spell out in plain English (in its proxy statement) what a failure to elect a single director or a majority of directors would mean to that company and its shareowners. Companies will need to inform shareowners of the consequences of a failed majority vote (violation of debt covenants, the automatic cancellation of a line of credit, etc.) so that shareowners could make an informed choice.

The possibility of such circumstances emphasizes the need for the Committee to work diligently with both the business and investor communities to address these contingencies. It also reflects a need for the nominating committees of listed companies to seek individuals who will pass muster with investors in the first place.

Other Observations/Issues

The Minimum Plurality Option

The Committee also offers a "Minimum Plurality Approach" as an alternative to the current plurality system in which one vote can elect a director. Such an approach would require directors to garner a minimum percentage of "yes" votes, such as one-third of total votes, in order to be elected. This alternative is an improvement over the current system, but falls short of the majority support the Centre believes a director must gain in order to serve as a shareowner representative.

A Slowdown in the Move to Declassify Boards

Some argue that a majority-vote requirement would destabilize corporate boards, and thereby lead to a number of acts by companies to further entrench boards. One possibility could be a slowing of the recent move to further declassify boards.

In an era when the financial community has been made more aware of the importance of corporate governance, we question whether many companies would chose to re-classify their boards, although the rate of declassification may slow.

The 50% threshold needed to vote a director off the board will undoubtedly make such an event quite rare. Institutional investors and issuers alike need to understand that such action will likely only be taken in extreme circumstances, and by the very nature of the standard, only with the majority approval of shareowners.

Current NOBO/OBO Rules make it hard for Issuers to Communicate with Shareowners
It is currently difficult for corporations to identify their shareowners and communicate with those shareowners under the current NOBO/OBO rules. These regulations could keep a company from passing on adequate information to shareowners in the event a director fails to achieve a majority vote.

The Centre supports a further review of these rules to allow a higher level of communication between companies and their shareowners. We advocate practices that allow issuers to communicate directly with shareowners, including owners who hold in a "street name."

The Centre strongly encourages the Committee to work with the SEC, the NYSE, NASDAQ and other interested parties to address what pertinent changes could be made to the NOBO/OBO rules in order to support the standard of majority voting.

Growing Support among Shareholders and Companies Themselves
In a paper released late in July of 2005, ISS reported on the growing support for Majority Elections.[2] Following the 2005 spring proxy season, ISS found that resolutions for the majority voting received an average "yes" vote of nearly 45% across 60 separate U.S. companies. The average support for such resolutions in 2004 was in the neighborhood of 12%.

A number of Corporate Issuers themselves are beginning to support the notion of majority voting in director elections. In June, corporate governance leader, Pfizer, announced that the board would in the future require any director receiving a majority withhold vote to offer their resignation to the board. Other forward looking companies such as N-Viro International, Lowe's and Dillard's have either planned to issue a management proposal supporting majority elections or have announced that their board's are currently considering the issue.

The CFA Centre thanks the ABA for furthering the dialogue in this important endeavor to give a greater voice to shareholders and hold directors accountable in their role as shareholder representatives.

Respectfully,

/s/ Kurt N. Schacht, JD, CFA____
Managing Director
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[2] Preliminary 2005 Postseason Report, Corporate Governance at a Crossroads – Institutional Shareholder Services