CFA INSTITUTE | Centre for Financial Market Integrity

24 September 2009

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

Re: Facilitating Shareholder Director Nominations: Proposed Proxy Rule (Exchange Act Rule 14a-11) and amendment to Rule 14a-8(i)(8) (File Number S7-10-09).

Dear Ms. Murphy:

The CFA Institute Centre for Financial Market Integrity ("CFA Centre" or the "Centre")[1], in consultation with its Capital Markets Policy Council, is pleased to comment on the Securities and Exchange Commission's (the "SEC" or the "Commission") *Proposed Rule Relating to Facilitating Shareholder Director Nominations* (the "Proposals"). The CFA Centre represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency and integrity of global financial markets.

Executive Summary

In general, the CFA Centre supports the Commission's Proposals. In particular, the Commission's proposed Rule 14a-11 to give shareowners direct access to annual proxy statements to nominate possible board members is key to ensuring this type of access. We also support amending the proxy rules under Rule 14a-8 to include shareowner proposals for changing companies' governing documents in annual proxy materials. We do not advocate going forward with just one of the proposals (Rule 14a-11 or 14a-8) discussed in this paper at the expense of the other. We support both proposals and believe they are both required to adequately improve the proxy process. Rule 14a-11 will offer a uniform standard for shareowner nominations at all public companies, instead a patchwork of access standards that would likely evolve if Rule 14a-8 were adopted without the adoption of Rule 14a-11.

With regard to specific elements within the proposals, the Centre has the following suggestions regarding various aspects of the Proposals:

[1] The CFA Centre for Financial Market Integrity is a part of CFA Institute, a global, non-profit professional association of nearly 97,600 financial analysts, portfolio managers, and other investment professionals in 135 countries and territories of which more than 85,490 are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 Member Societies and Chapters in 57 countries and territories

Charlottesville New York Hong Kong London
560 Ray C. Hunt Drive
PO Box 3668
Charlottesville, VA
22903-0668 USA
434 951 5499 tel
434 951 5262 fax
info@cfainstitute.org
www.cfainstitute.org

1. A single ownership threshold should apply for all companies regardless of size or industry, and the threshold should not exceed 3 percent.
2. The Centre does not support requiring nominating shareowners to pledge that they will not use the nomination to effect a change in control of the company. The limitation on the percentage of board members that a shareowner can nominate makes this pledge redundant.
3. The Centre does not support the independence requirements for shareowner-nominated directors. The Centre believes the relevant issue is whether the shareowner nominee is independent from the company and executive management, not the nominating person or group.
4. Finally, the Centre does not support limiting shareowner access to the proxy statement to the first individual or group to submit a qualified nominee. Instead, the Centre believes a better mechanism would determine inclusion on the basis of the largest percentage share ownership of the submitting qualified shareowners or groups.

In consideration of the concerns noted above, the Centre believes the Proposals will strike an appropriate balance between giving large, longer-term shareowners a voice in board nominations while not allowing those shareowners to misuse the process or otherwise overwhelm the existing board.

These positions are discussed in more detail below.

Background and Proposed Changes

Granting shareholders the ability to nominate directors on a corporate proxy slate is an issue that the Commission has addressed regularly since 2003. In a proposal released in October of that year[2], shareowners would have had the right to nominate someone for the board of directors if they held 5 percent or more of a company's shares for at least one year. That proposal was ultimately abandoned, as was another in 2007. Since that time, the idea of proxy access as a means of increasing board accountability and a way of giving shareowners a voice on corporate boards has languished.

Some opponents of the Commission's current access proposal state that they favor a more incremental approach whereby companies and shareowners themselves would choose a proxy-access standard that fits their corporate models. Such arguments cite the recent voluntary implementation of majority-voting standards in director elections at more than half of all S&P 500 companies as a model of the success of an incremental approach.

In many cases, however, companies adopted majority voting only after years of pressure from shareowners (majority-voting proposals receiving greater support each year) and concerns that an unfavorable majority-voting standard might be mandated. Companies and boards have not moved on proxy access, with many having refused to support the idea in the six years since the SEC first addressed the topic.

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[2] See response of AIMR (now CFA Institute) from 22 December 2003: http://www.cfainstitute.org/centre/topics/comment/2003/03shd_nominations.html

Making changes to these kinds of governance systems is a complex process as shown by the migration to majority-voting standards at many S&P 500 companies. The switch to majority-voting, for example, has forced investors in multiple S&P 500 companies to become familiar with a number of different processes in order to adequately understand and exercise their voting rights.

Proposed Rule 14a-11 would give shareowners greater authority to nominate board members and require companies to include those nominees in their annual proxy statements. Shareowners also would be permitted to work with other shareowners to form shareowner groups to submit nominations. To take advantage of these benefits, the Commission would set a number of eligibility requirements, including the following:

- Shareowners must own at least 1% of the shares in large accelerated filers ("LAFs"), 3% for accelerated filers ("AFs"), and 5% for non-accelerated filers ("NAFs").
- Shareowners must have held the shares for at least one year prior to proposing nominees to appear in a company's proxy statement;
- If the nomination is submitted by a shareowner group, then each member of the group must comply with each of the eligibility requirements;
- Shareowners seeking to nominate someone for a board must pledge that they do not wish to use the nomination as a means of changing control of the company;
- Nominating shareowners must pledge to hold their shares at least until the board election is complete;
- Nominating shareowners would be limited to nominating one board member, or 25% of a company board's total members, whichever is greater;
- The nomination must comply with laws in the state in which the target company is incorporated;
- The nomination must comply with that company's governing documents; and
- Only the first qualifying nominating shareowner or group submitting a nominee to a target company would be included in the company's proxy statement.

Rule 14a-8 would change proxy rules to permit shareowners in certain circumstances to propose binding amendments to companies' governing documents. These amendments would specifically allow them to include their board nominees in the proxy statements.

Comments on Specific Proposals

A. Application of Exchange Act Rule 14a-11

As a matter of principle, the CFA Institute Centre believes that shareowners should have a right to nominate board members under certain circumstances, and that those nominees should be included in company proxy statements. As the capital providers in these companies, shareowners should have an

opportunity to nominate individuals who they believe will serve their interests. We have previously stated our support for this position to the Commission.[3]

The Centre believes that the proposed Exchange Act Rule 14a-11 provides a uniform mechanism for achieving this goal, and therefore we support the Proposal for the new rule. As noted above, companies under the new rule would "have to include shareowner nominees for director in the companies' proxy materials" in certain circumstances. The Proposal goes on to describe some of these circumstances, including that "[t]his requirement would apply unless state law or a company's governing documents prohibits shareowners from nominating directors."

The Centre further believes that this Proposal will work well in combination with a number of other corporate governance changes originating elsewhere. While there are risks that these changes could lead to the election of unqualified board members or board members whose interests are not aligned with those of other shareowners and who may deflect boards' attention away from their primary role, we believe the potential benefits from boards hearing shareowner voices more directly outweigh these concerns. Additionally, if elected, any nominee would likely have to receive a majority of votes to remain on the board in future elections due to the increasing adoption of a majority-voting standard in director elections at U.S. companies.

Triggering events. We support the Commission's decision not to require a "triggering event" for the Proposals to come into effect. Beyond the needs for a nominating shareowner or group to satisfy a percentage ownership threshold for at least a year, we believe the triggering events proposed in the Commission's 2003 proposals—withheld votes accounting for more than 35 percent of votes cast for at least one board nominee; and 50 percent of votes cast approved a proposal for shareowner nomination procedure changes—would be too onerous to achieve the goal of the Proposals under current circumstances.

B. Eligibility to Use Exchange Act Rule 14a-11

In our 22 December 2003 letter to the Commission on board member nominations, we stated that all companies, regardless of size, industry, or any other factor, should abide by the same eligibility rules for shareowner ownership. The Centre stands by this view and does not support provisions in the Proposals to set different ownership thresholds for nominating shareowners of LAFs, AFs, and NAFs.

The percentage share ownership the Commission should require for nominating shareowners should not exceed 3%. While this threshold is smaller than the trigger for Forms 13-G, it is not so small that it would allow a board nomination for only a *de minimis* investment in an NAF. At the same time, it would not be so large as to prevent all but the largest institutional shareowners to submit nominees for LAFs. The Commission's proposal to limit the number of board seats affected by this new rule are sound and would provide additional protection against investors using this process to obtain control through the annual proxy process (see discussion below).

The Centre also supports the proposed one-year holding period to qualify as a nominating shareowner. This time frame is sufficient to indicate a commitment to a longer-term investment and is similar to the holding period requirements for submitting other shareowner proposals.

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[3] See Centre official positions on board member nominations at http://www.cfainstitute.org/centre/topics/governance/official/director_nominations.html.

The Centre does not support the proposed requirement that nominating shareowners or groups represent that they will not seek changes in control in companies through the proxy "access" process, or use this process to gain more than a limited number of seats on the board in the future. The limitations on the number of seats subject to shareowner nominees should prevent such changes in control through the normal proxy process. It is also likely that companies will generally know the "intent" of each of their larger shareowners due to past dealings with them. Therefore the Centre believes that it is unnecessary to ask shareowners to make such a "loyalty oath." Moreover, it is possible that the sentiment of a nominating shareowner or shareowner group could change over time. For example a group that had no intention of seeking a change in control upon the nomination of a board member could over time become disenchanted with the strategic vision of a company's management and subsequently wish to seek a change of control.

Companies that have more than one class of securities entitled to vote pose a special concern. The Centre believes that the standard set by the Commission with regard to shareowner nominations needs to be clearer about situation in which a company has multiple classes of shares with disparate voting rights. We believe a "one share, one vote" standard should apply in such cases, and that all shares should be treated equally in determining the eligibility thresholds for nominating shareowners.

Another provision in the Proposal would permit shareowners to "aggregate holdings for purposes of meeting the eligibility thresholds in Rule 14a-11." The Centre supports this proposal, and would further support a requirement that all members of a nominating shareowner group individually meet the eligibility requirements. The Centre also supports the provision that would make a group ineligible if any member of a group does not comply with these eligibility requirements. The Centre encourages the Commission to consider further whether a group formed solely for the purpose of 14a-11 and which surpasses a 5% ownership threshold should be required to submit a 13D filing as a group. We believe that a13D filing under such conditions would be unnecessary and somewhat redundant.

C. Shareowner Nominee Requirements

The Centre supports the Commission's decision to make eligibility and application of the proposed Rule 14a-11 conditional upon compliance with state law and company governing documents.

The Proposals also would require that a nominee should be independent of the shareowner or group that submits the nomination. The Centre believes the relevant point is whether the nominee is independent of the company and its management. In fact, it is unlikely that a nominating shareowner or group would nominate someone they did not know. If they were to do so, they would not be assured that the nominee shares the same perspectives and interests. Therefore, while we support disclosure of such affiliations, we do not believe that the eligibility criteria for nominees should be limited by such affiliations.

D. Maximum number of shareowner nominees to be included in company proxy materials

The Centre supports the proposal to include a limitation on the number/percentage of shareowner board nominees resulting from the Proposals' new processes. Such limits – the greater of one seat or 25 percent of all seats – would permit shareowners to obtain a voice on the boards of companies, while also restricting the ability of certain shareowner groups to gain undue influence.

The Centre urges the Commission to base these limits on the total number of board seats and not only the board seats that the nominating shareowner is entitled to vote on. For example, if a board consists of 10 directors, but five of those seats are reserved to a certain shareowner or shareowners (for example, a holder of a different class of shares or a separate corporate entity), then the limits on nominations should relate to the full 10 board seats.

E. Priority of Nominating Shareowners

The Centre is concerned with the proposal to let only those nominating shareowners or groups that provide first notice get their nominees in their companies' proxy materials. We are concerned that this may lead to a "race to file," regardless of the quality of the nominees.

Instead, the Centre suggests an approach that gives first priority to the largest shareowners or groups who are prepared to submit nominations. If such a shareowner or shareowner group were to lose their eligibility, then the privilege would fall to the second-largest shareowners or groups with prepared slates of nominees. While this could encourage groups to seek more and more participants to join with them to ensure their nominees stand a better chance of getting on the proxy statements, the Centre believes this process could benefit shareowners. In particular, such a competition would require that the nominating groups promote their candidates in a way that encourages other shareowners to make reasoned choices. Furthermore, the cost of such efforts might prohibit all but the most fervent shareowners or groups from undertaking such efforts. Ultimately, though, shareowners would be given a better chance to obtain a voice on their boards, which is the goal of proxy access efforts.

Finally, the Centre believes that shareowner groups that put forth nominees should have to prioritize their nominees in the case where there are more nominees than available spots under the rule. For example, if the final rule allows more than one nominee or nominee group to vie for a limited number of director seats, and one or more of these nominators wishes to nominate more than one individual, that nominator must list their potential nominees in order of priority in case only a limited number of their nominees are ultimately chosen to stand for election.

F. Note and Disclosure Requirements

The Centre supports the proposed disclosure requirements for shareowner nominations. Under this provision, nominating shareowners would have to provide notice on Schedule 14N to the company of its intent to require that the company include that shareowner's nominee in the company's proxy materials. The Commission notes that such disclosure would assist all shareowners in making an informed voting decision with regard to any nominee put forth by a nominating shareowner. The Centre believes that these disclosures will benefit shareowners by helping them understand the experience, and perspectives of the nominees.

G. Requirements for a Company Receiving Notice from a Nominating Shareowner or Group

The Proposals detail the processes that companies receiving shareowner nominations would have to adhere to, including the steps that must be taken by all parties for a nominee to be included on the corporate proxy ballot. They also include detailed instances where a company may exclude a shareowner nominee.

The Centre supports the proposed mechanisms detailed in the Proposals, as they describe a thorough process that ensures only those shareowners who meet the requirements of this proposal have the right to nominate directors to appear on the corporate proxy.

H. Amendments to Exchange Act Rule 14a-8(i)(8)

Rule 14a-8(i)(8), as currently written, allows companies to exclude from their proxy statements any shareowner proposals that relate to nominations for company board elections, or to procedures for such nominations or elections. With the current Proposal, the Commission seeks to amend this rule so that, under certain circumstances, companies would have to include shareowner proposals in their proxy statements that would amend the company's governing documents on nomination procedures or disclosures. This amendment would not apply if the shareowner proposal would prevent shareowners or groups from having their nominees included in the proxy statements. Nor would it apply if it were used to excuse nominating shareowners and their nominees from liability for false or misleading disclosures.

The thresholds that shareowners would have to meet to file such a proposal would be similar to those currently required under this section of the Commission's rules. Specifically, they would need to have at least $2,000 invested in the target company's shares for at least a year.

The Centre supports the proposed amendment to Rule 14a-8(i)(8) as an important element in ensuring that shareowner access proposals are included in company proxy statements. We also believe that the proposed amendments will deter "gaming" of the 14a-11 process by companies and prevent other groups from circumventing the process by limiting the rights of shareowners to participate in the director nominating process.

Concluding Comments

The CFA Institute Centre for Financial Market Integrity is pleased to submit its views on the Commission's proposals, *Facilitating Shareowner Director Nominations: Proposed Proxy Rule (Exchange Act Rule 14a-11) and amendment to Rule 14a-8(i)(8).* If you or your staff have questions or seek clarification of our views, please feel free to contact either Kurt Schacht, CFA, at +1.212.756.7728 or kurt.schacht@cfainstitute.org, or James C. Allen, CFA, at +1.434.951.5558 or james.allen@cfainstitute.org.

Sincerely,

/s/ Kurt Schacht

Kurt Schacht, CFA
Managing Director
CFA Centre for Financial Market Integrity

/s/ James C. Allen

James C. Allen, CFA
Head, Capital Markets
CFA Centre for Financial Market Integrity