TEACHERS' RETIREMENT BOARD
TEACHERS' RETIREMENT SYSTEM
55 Water Street, New York, N.Y. 10041

479

December 18, 2003

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

Re: File No. S7-19-03
Security Holder Director Nominations

Dear Mr. Katz:

On behalf of over 140,000 active and retired members of the Teachers' Retirement System of the City of New York (TRS), with invested assets in excess of $13 billion in the Variable Annuity Programs, we welcome this opportunity to offer support to the Securities and Exchange Commission's (SEC) Proposed Rule: Security Holder Director Nominations.

As long-term investors in the equity securities of public companies, TRS has long advocated for good corporate governance reforms through dialogue with companies, the shareholder proposal process, active membership in the Council of Institutional Investors, and entreaties to legislative and regulatory bodies, including the SEC. We believe these activities are fully consistent with our fiduciary obligation to the current workers and retirees who are members of TRS.

TRS is pleased to provide comment on the Commission's Proposed Rule: Security Holder Director Nominations. We commend the Commission for proposing this Rule. It is, undoubtedly, one of the most significant actions taken to reform corporate governance and restore investor confidence in the aftermath of corporate scandals that have caused massive losses to investors and created a crisis of confidence in the U.S. equity markets.

Under our current system of corporate governance, shareholder nominations are effectively precluded even when directors have consistently demonstrated bad judgement and companies have performed poorly over long periods of time. Among the thousands of companies that are publicly traded, contested elections occurred in fewer than 80 during the seven-year period 1996-2002. The majority of the contested solicitations did not involve attempts to replace the board with a new team that would run the firm differently, and about a quarter of the cases did not involve the choice of directors at all, but rather other matters such as proposed bylaw amendments. Among the cases that did focus on elections for directors, a majority involved a fight over a possible sale of the company or over a possible opening or restructuring of a close-end fund. In the absence of an attempt to acquire the company, the prospect of being removed in a proxy contest is far too remote to provide directors with incentives to serve shareholders [1].

[1] Lucian Arye Bebchuk, *The Case For Shareholder Access To The Ballot*, John M. Olin Center For Law, Economics, and Business, Harvard Law School, Discussion Paper No. 428 (Cambridge, MA: Harvard University, 2003), pp. 3-5.

Thus the ability of shareholders to replace directors will provide an effective tool in restraining director betrayal of the fiduciary trust. For this reason, the Teachers' Retirement Board of the City of New York firmly supports the intent of the Proposed Rule: to improve disclosure to security holders to enhance their ability to participate meaningfully in the proxy process for the nomination and election of directors. We appreciate the opportunity to offer suggestions for making the Rule more practical for qualified shareholders and effective in achieving its intended purpose.

However, before offering our suggestions, let us take this opportunity to respond to the unwarranted fears and predictions of opponents that the Proposed Rule will be abused by shareholders and create chaos in company board rooms. As fiduciaries of TRS, we have a legal and moral duty to protect the assets entrusted to us. We have no interest in attempting to control companies in which we invest, or in disrupting and impeding the functioning of management and boards to the detriment of companies and their shareholders. As we have done for more than two decades, we will continue to seek corporate governance reforms at selected under-performing companies through constructive engagement and the shareholder proposal process. We assure you that the Proposed Rule would be a measure of last resort that would be utilized only at egregious companies.

However, there are some aspects of the Rule on which we disagree, and offer suggestions for improvements:

Triggering Events

The proposed applicability of the Rule based on triggering events undermines what should be a fundamental right of shareholders: unfettered access to a company's proxy materials to present nominees for election to the board. It is our sincere hope that the Commission will recognize this right of security holders and its importance as a fundamental principle of good corporate governance. In so doing, the Commission would strengthen the rights of U.S. shareholders, as has been done in the United Kingdom and other industrial countries in the global economy. In the UK, shareholders of public companies have the right to include a resolution at an Annual General Meeting for the election of a director. A simple majority vote is all that is required to pass such a resolution, which is binding upon a company.

However, if the Commission will not be persuaded on this issue, we urge you to include additional triggers that are clear indicators of the need for an effective proxy process and a company's unresponsiveness to shareholders. Perhaps the most compelling of such indicators is a company's non-implementation of a shareholder proposal, submitted in accordance with Exchange Act 14a-8, that is supported by the majority of votes cast.

The final rule should also include additional triggering events that are not precipitated by a shareholder proposal or other security holder actions. Such events should include significant under-performance, over an extended period of time, compared to appropriate industry peer groups, malfeasance of top executives and directors, including criminal indictments and SEC enforcement, restatements of earnings, and being delisted from an exchange.

With respect to the Rule's proposed two triggering events, we urge the Commission to lower the proposed withhold vote threshold to 20% from the proposed 35%, and to eliminate the proposed 1% ownership threshold for submitting a shareholder proposal requesting proxy access. Regarding the latter, the Rule should apply the same standards for submitting a shareholder proposal under Exchange Act 14a-8.

To activate the proxy access process, the Rule should only require that the "direct access" proposal is supported by a majority of the votes cast, and that vote would be binding on the company.

The Proposed Time Period for Application of the Rule

The Proposed Rule effectively requires two annual elections before a shareholder nominee could be elected. The delay, inadvertently, could extend the period of risk–exposure and loss of shareholder investments in situations where expedited replacement of directors would be most beneficial.

In addition, we recommend that once the proxy access process is activated it stays effective for a five-year period. The proposed two-year period narrowly limits the ability of shareholders to monitor director responsiveness and to engage willing boards in productive dialogue.

Limiting the Number of Shareholder Nominees

While we agree that the Rule should provide safeguards against a shareholder or shareholder group taking control, we disagree with the proposed limitation on the number of shareholder nominees that could be included in a company's proxy materials. For example, limiting the number to one nominee if the total number of members of the board of directors were eight would most likely be ineffective. The likelihood that a single director would be able to effectively influence meaningful change against the opposition of seven intransigent members is very low, if not unrealistic. Accordingly, we recommend that, irrespective of board size, the Rule should provide for two nominees or up to 35% of the seats on the board, whichever is larger.

Shareholder Nominee Standards of Independence

We are concerned that the proposed shareholder nominee independence standards are overly broad. While we agree that nominees should be required to meet exchange standards of independence, we see no useful purpose in the proposed disqualification of shareholder nominees based simply on affiliation with the nominating shareholders. Indeed, alignment between the nominee and the nominating shareholder or shareholder group could be beneficial to all shareholders.

Other Recommendation:

Eliminate Uninstructed Broker Voting
We recommend that the Rule include a prohibition against financial intermediaries voting client shares in director elections, without instructions from clients. Absent this provision, the Rule would create a gapping loophole for "ballot-box stuffing".

In conclusion, we believe that granting shareholders the right to effectively replace directors is a critical step in reforming our system of corporate governance. When shareholders have direct access to a company's proxy materials to nominate directors, directors will be motivated to uphold their fiduciary obligations and make the protection of shareholder interests their highest priority.

We urge the Commission to revise the Proposed Rule to reflect the serious concerns and recommendations of the Systems and other institutional investors—the majority shareowners of publicly traded companies.

We thank you for the opportunity to comment. If you have any questions, please feel free to contact Stanley J. Kessock, Executive Director of TRS, at (212) 612-5405, or by e-mail at: skessock@trs.nyc.ny.us

Very truly yours,

The Teachers' Retirement Board

Martha E. Stark
Chairperson - Martha Stark

TRB:sk:ls