Richard H. Moore
Treasurer State of North Carolina
Security Holder Director Nominations Roundtable
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549
March 10, 2004

I support the Securities and Exchange Commission's proposed rule concerning Security Holder Director Nominations (34-48626). As sole fiduciary for the North Carolina Retirement System and its 688,000 beneficiaries, I commend the SEC for putting forth this proposed rule. As outlined in this testimony, I believe this rule is essential to the proper oversight of public companies, especially for institutional investors. Despite the many reforms embodied in Sarbanes-Oxley and the new listing requirements set forth by the New York Stock Exchange and approved by the SEC, there is an urgent need to give long-term investors the ability to seek some form of representation on the board of directors when the board or management fail investors.

In the next several sections, I want to address three areas. First, it is important for the SEC to understand the nature of equity ownership by public funds. While North Carolina's commitment to equities is somewhat below the average for most public funds, the types of mandates and securities we own are representative of public plans. Despite our size, we own very small proportions of most companies. Moreover, a great deal of our exposure is in index and structured equities, where the proxy is our only effective form of corporate governance. The existing proxy process needs to be reformed because it was created long before most public funds and other pension plans were empowered to invest in equities. Second, I want to address our potential use of the

proposed rule, and put to rest some of the unfounded fears of opponents of the proposed rule. Finally, I want address several areas where the rule should be strengthened.

North Carolina Retirement System: Equity Ownership

Twenty-five years ago, the North Carolina Retirement System had $3.9 billion in assets with 87% in fixed income assets, 2% in cash and only 11% in equities. We employed two active managers, Thorndike, Dornan, Paine and Lewis (known today as Wellington Management) and Alliance Capital to manage $433 million in equities. Our commitment to public equities has grown dramatically over the years in concert with most other public funds.

Today we have approximately $35 billion in equities, representing 56% of our assets. In order to prudently manage these assets, we have employed a variety of strategies including major commitments to passive and structured equity mandates. The table below sets out how North Carolina's equity investments are managed. Among our domestic holdings, which would be the subject of the proposed rule, only 22.4% (see Table 1) of the securities are held by active money managers. Thus, the vast majority of our domestic equity exposure cannot "vote with its feet" or sell holdings in situations where our managers do not approve of a board or its actions.

Table 1
North Carolina Retirement System
Equity Allocation by Sub-Classes and Strategies
February 29, 2004

	Allocation	Active	Structured	Indexed
Large Cap	59.5%	25.0%	30.4%	44.6%
Mid Cap	12.4%	5.5%	26.2%	68.3%
Small Cap	13.5%	26.4%	41.0%	32.6%
Domestic Equities	85.4%	22.4%	31.5%	46.2%
International	14.6%	100.0%	0.0%	0.0%
Total	100.0%	33.7%	26.9%	39.4%

Even in the case where we have active exposure, we believe that "voting with our feet" is a poor remedy and is not a substitute for reasonable participation in and access to the proxy. First, by the time significant issues become apparent, our active managers are often forced to realize significant losses on our behalf. Second, our fund incurs significant transaction costs when it is forced to sell in order to avoid poor corporate governance. Our 25 largest positions have an average value of $286 million, so it is quite likely that the total cost of liquidating one of these positions might run anywhere from 0.25% to 1.00% or more, or between $0.75 million to $2.9 million. The cost of having to rely on selling as a remedy for ineffective board governance is very high, and in all likelihood much higher than the cost of the proposed rule.

Our domestic equity exposure consists of over 2,400 securities. On average we own 0.39% of each of these companies. However among our 100 largest holdings (46% of our domestic equities), we only own 0.24% of these companies. Despite the large size of

our portfolio, we have a 2% or greater position in only 33 securities representing 1.65% of our portfolio (see Table 2). The largest ownership is 4.65%. Those companies have an average market capitalization of only $637 million. While we have a sizable stakes in these companies, insiders own 22% of these companies (see Table 3). In other words, our interests are probably fairly well aligned since the insiders have a sizable stake. Moreover, if we were to invoke one of the triggers in the proposed rule, these companies would be well positioned to defeat our initiative if they were so inclined.

In fact, for 78% of our holdings we own 0.50% or less of the company, and about half of our holdings are less than 0.25%. While equities have become increasingly important to our program, the vast majority of our ownership is so small that it will require agreement among many investors to meet the various triggers of the proposed rule, or to ultimately prevail in electing a slate of directors.

Table 2
North Carolina Retirement System
Percentage Ownership of Securities
February 29, 2004

Percentage of the Security Owned by North Carolina Retirement System	Proportio of Domestic Equity Holdings	Number of Holdings
Greater or equal to 2%	1.65%	33
Greater or equal to 1.5%, Less than 2%	1.21%	31
Greater or equal to 1.0%, Less than 1.5%	3.39%	95
Greater or equal to 0.75%, Less than 1%	5.10%	138
Greater or equal to 0.50%, Less than 0.25%	10.02%	256
Greater or equal to 0.25%, Less than 0.50%	29.09%	892
Greater or equal to 0.10%, Less than 0.25%	45.71%	462
Less than 0.1%	3.84%	515
Total	100.00%	2422

Where we have a great deal of value at risk, in our top 25 equity holdings, we have a very small ownership percentage. Among our largest 25 holdings, on average, we only own 0.20% of any one security. Yet the companies represent 24.2% of our domestic equities. Among these securities, insiders only own 6.1% of the company (less than 5% excluding Wal-Mart), thus making the alignment of interest with management much more tenuous.

Table 3 provides a summary of the contrast between our largest holdings and the companies where we have the largest ownership interest.

Table 3
North Carolina Retirement System
Ownership Characteristics Top 25 Holdings and
Positions with Ownership Greater than 2%
February 29, 2004

	Average Ownership	Insider Ownership	Average Market Cap (US $ billions)	Proportion of Domestic Equity Holdings
Top 25 Holdings	0.2%	6.1%	155.23	24.2%
2% or greater ownership	2.6%	22.1%	0.64	1.7%

Potential Use of the Rule

Some opponents of the rule have argued that the SEC should wait to see how all the new provisions of Sarbanes-Oxley and the NYSE listing will impact governance. These new requirements set forth the qualifications of directors, the composition of the board and its committees and certain new responsibilities of management in certifying operating results and corporate procedures. Nothing in these new laws or listing requirements gives the

owners the ability to intervene if the directors or management steer the company on the wrong course. Moreover, no set of new laws or regulations can substitute for the ability of owners to seek at least some representation when they lose confidence in the existing leadership. The new reforms may prevent some situations where long-term investors might otherwise have to utilize the proposed rule. However, there is no harm in enacting the rule, and having it as a backup.

Opponents of the proposed rule are predicting an onslaught of shareholder initiatives as a result of this rule. This fear is wholly unwarranted. Our retirement system needs and expects every company we own to generate value for our beneficiaries. As long-term shareholders, we ultimately bear all the costs and risks associated with invoking the provisions of the proposed rule. Although the various triggers may afford us numerous opportunities to invoke the provisions of the rule, I see the process being invoked in a limited number of circumstances. Moreover, we will exhaust all other means of discussion and persuasion with management before heading down the path laid-out by the proposed rule. We have little interest in incurring corporate expenses or distracting management from its primary mission unless it is absolutely necessary. Thus, we expect that the various triggers will guide us toward a universe of companies from which a limited number may ultimately become subject to the process outlined in the proposed rule.

Opponents of the proposed rule are predicting that public pension plans will act monolithically and automatically in initiating the procedures under the proposed rule or

supporting the alternative directors. While I am in complete agreement with the many public pension plans and State Treasurers supporting this rule, as a fiduciary I have a responsibility to evaluate each situation that may arise under this proposed rule and carefully scrutinize the qualifications of any proposed director.

While we oversee large portfolios – our pension assets were $61 billion as of February 29, 2004 – we do not have the resources either individually or collectively to run an independent slate of directors. Thus, this proposed rule is our only practical means of obtaining a voice in the board of one of our companies, when management and the incumbent board let us down.

The strong opposition by many in the corporate community to the proposed rule comes as something of a surprise to me. Public pension plans are virtually permanent owners of most public companies in the United States. While our position may rise or fall marginally from year-to-year, most public pension plans, including North Carolina will, in fact, own most companies through good and bad times. As a consequence good corporate governance and meaningful access to the proxy are our only truly effective tools to protect our beneficiaries. Public companies would not survive for long if they treated their best customers the same way they are treating their most loyal investors.

Strengthening the Proposed Rule

On December 18, Sean Harrington, Executive Director of CALPERs, Alan Hevesi, Comptroller of the State of New York and I submitted comments on the proposed rule on

behalf of National Coalition for Corporate Reform . I want to reiterate the points of our position.

Triggers: In principle, I do not believe that triggers are appropriate or necessary. Shareholders are owners and should have the right with reasonable qualifications to nominate directors when necessary. However, since the SEC is determined to implement triggers, I believe the triggers can be more effective. As NCCR urged, there should be an additional event driven trigger.

Under the proposed rule, access to the proxy for nomination purposes is conditioned on one of two "triggering events" occurring:

- At least one of the company's nominees for board of directors for whom the company solicited proxies received "withhold" votes from more than 35% of the votes cast at an annual meeting held after January 1, 2004; or
- A security holder proposal, adopted after January 1, 2004, providing that the company become subject to the shareholder nomination rule, was submitted by a shareholder or group that held more than 1% of the securities entitled to vote for at least one year, and received more than 50% of the votes cast on that proposal.

The first trigger, the percentage of withhold votes should be reduced to 20% from 35%. A 20% withhold vote is clear evidence of significant shareholder dissatisfaction, and represents a significant hurdle for shareholders undertaking a withhold campaign, thereby limiting the number of companies affected by such a trigger. The NCCR's analysis of recent withhold votes indicates that there have been no cases of a 35% withhold vote at a

sample of 100 Fortune 500 companies. Using the same sample, a 20 percent vote level was achieved at about 15 percent of the companies.

The data for the North Carolina Retirement System discussed earlier, show that even the 9th largest public pension plan only owns 0.20% of the largest companies in its equity portfolio. Thus a 35% withhold would require us to find 15 to 20 other large investors just to invoke the trigger.

Additionally, the SEC should remove the 1% ownership threshold included in the second trigger. The holdings of a shareholder sponsoring the access proposal are irrelevant - the focal point here should be that a majority of shareholders must vote in favor of the proposal in order to trigger proxy access.

The SEC also requested comment on a possible third trigger - company inaction on a shareholder proposal that receives a majority vote. I agree with the NCCR that shareholders should have proxy access when a board fails to act on a majority vote proposal. A majority vote is a strong directive from the owners of the company to act on a particular issue that should not be disregarded, often year after year. Such circumstances clearly indicate an ineffective proxy process.

The two triggers included in the proposed rules require a two-year process to elect a director - a triggering event must occur in year one, thereby allowing shareholder nominations using the company's proxy materials in year two. That may be reasonable when underlying shareholder dissatisfaction relates solely to the proxy process. However, a two-year process is too lengthy when substantial mismanagement, or worse, puts the

value of shareholders' assets at immediate risk. I strongly believe that there should be an additional trigger tied to specific events such as SEC enforcement actions, indictment of any executive or director on criminal charges directly related to his or her corporate duties, material restatements, delisting by a market, or significant share under-performance relative to an applicable peer group for an extended period. The occurrence of any of these events should trigger proxy access for the next shareholder meeting at which directors will be elected. Each of these events is consistent with criteria relating to shareholder dissatisfaction with the existing board or management.

Once triggered, proxy access would be granted to a shareholder or group owning more than 5% of a company's securities for at least two years. Clearly, unfettered proxy access would not serve the interests of shareholders or the business community; however a 5% threshold is too onerous and will prevent many shareholders, including many institutional investors, from exercising this right. Instead, I support a 3% ownership threshold as an appropriate measure of a "significant" investor.

Number of Nominees: The NCCR advocates that the number of shareholder nominees permitted should in no instance be less than two. Accordingly, I suggest that the rule permit either two shareholder nominees, or a maximum of 35% of the seats on the board, whichever is greater. In our experience, it is very difficult for a single director to promote change or have an effective voice. Limiting the number of nominees to one under any circumstances would impair the proposed rule from achieving its stated goal of providing a mechanism for dissatisfied shareholders to seek greater representation. While this rule should not permit shareholders to seek control, the proposed limitation on the number of

nominees is too constrictive. Since shareholder nominees would still be required to obtain a majority vote to be elected, all shareholders ultimately will determine whether shareholders have nominated too many candidates for a particular board.

Time Period for Application of the Rule: The rule, once triggered, should remain operative for a period of five years. The proposed time period of two years is too brief to permit owners the ability to monitor performance and responsiveness and react accordingly. As an unintended consequence of the two-year period, the rule could encourage investors to nominate candidates in situations in which they might otherwise be willing to give incumbent board's additional time to address the underlying concerns that triggered proxy access.

Nominee Independence Standards: Nominees under this rule should be independent of the company. I also believe that reasonable independence standards should be applied to the relationship between the nominee and the nominating holder or group. However, I have serious concerns that the broad application of the proposed independence standards will inhibit significant holders from seeking seats on boards as part of actively managed governance strategies. For example, CalPERS has significant resources dedicated to actively managed strategies in the governance arena. Under these strategies, external managers such as Relational Investors may seek board representation in an effort to build long-term equity value in a company. As such, these individuals conduct rigorous fundamental research and take significant equity positions. These individuals are perhaps the most desired type of director because they are independent, extremely well aligned

with the owners, and very well prepared with an in-depth understanding of the company that other directors typically do not possess.

The NCCR developed a narrow exception to the proposed independence standards that would permit holders of at least 2% to nominate principals of the fund. I believe that this threshold would ensure that the nominating holder is a very significant investor. I have ultimate confidence in the election process and, reiterate that any shareholder nominee still must be elected by a majority. I fully support the disclosure requirements that would oblige the nominee to disclose their holdings, qualifications and affiliation with the nominating holder. With this information, it is appropriate to let the owners decide if a significant equity owner should be elected to the board to represent shareowners.

In the recent proxy vote, the North Carolina Retirement System held 2.1 million shares, down from 2.8 million shares at the end of 2002. In 2002, NCRS held 55% of the stock in indexes and the balance in structured and active equities. By the end of February 2004, our structured and active portfolios had reduced their exposure to about 16%, while the index exposure was 84%. The only effective means for exercising corporate governance rights in the index, and to some degree even the structured portfolios is through the proxy.

Exhibit 1
North Carolina Retirement System
Holdings of the Walt Disney Company

	2/29/2004	Pct	12/31/2002	Pct
Index	1,773,413	83.8%	1,540,784	54.7%
Structured	205,825	9.7%	638,336	22.7%
Active	136,310	6.4%	638,609	22.7%
Total Shares	2,115,548		2,817,729	
Market Value	56,125,488		45,957,160	

*** NC increased its active exposure slightly in 2003**

Exhibit 2
North Carolina Retirement System
Top 25 Holdings: Ownership Characteristics
February 29, 2004

	Security Name	Shares	Market Value	% owned	insider owned
1	CITIGROUP INC	11,169,177	556,448,398	0.22%	1.7%
2	MICROSOFT CORP	20,336,987	535,879,607	0.19%	14.7%
3	GENERAL ELEC CO	15,941,404	523,675,121	0.16%	1.0%
4	PFIZER INC	13,756,168	508,427,969	0.18%	1.0%
5	EXXON MOBIL CORP	10,940,388	458,402,257	0.17%	0.8%
6	WAL MART STORES INC	6,021,202	363,439,753	0.14%	39.0%
7	AMERICAN INTL GROUP INC	4,748,549	354,716,610	0.18%	4.0%
8	BANK AMER CORP	3,618,848	298,989,222	0.25%	1.5%
9	INTEL CORP	10,282,278	298,391,708	0.16%	3.0%
10	INTERNATIONAL BUSINESS MACHS	3,041,209	294,510,680	0.18%	1.0%
11	CISCO SYS INC	11,726,715	266,196,431	0.17%	2.0%
12	ALTRIA GROUP INC	4,569,888	264,825,010	0.23%	0.9%
13	JOHNSON + JOHNSON	4,746,146	252,589,890	0.16%	1.0%
14	PROCTER + GAMBLE CO	2,206,376	226,065,285	0.17%	1.0%
15	PEPSICO INC	3,892,933	204,106,477	0.23%	0.1%
16	LILLY ELI + CO	2,657,346	194,198,819	0.24%	14.6%
17	FEDERAL NATL MTG ASSN	2,549,419	194,087,268	0.26%	16.0%
18	VERIZON COMMUNICATIONS	4,890,839	190,742,721	0.18%	1.0%
19	BANK ONE CORP	3,374,959	186,533,984	0.30%	0.7%
20	DELL INC	5,197,597	172,248,365	0.20%	10.7%
21	TIME WARNER INC NEW	10,048,399	170,320,363	0.22%	8.6%
22	COCA COLA CO	3,410,203	167,577,375	0.14%	12.8%
23	MORGAN STANLEY	2,673,187	163,705,972	0.29%	14.0%
24	CHEVRONTEXACO CORP	1,757,488	157,875,147	0.16%	1.0%
25	MERCK + CO INC	3,261,647	153,656,190	0.15%	1.0%
	TOTAL/AVERAGE		7,157,610,622	0.20%	6.1%

Exhibit 3
North Retirement System
Ownership Positions Greater Than 2%
February 29, 2004

	Security Name	Shares	Market Value	% owned	insider owned
1	NUI CORP	3.9%	12,362,471	4.5%	3.9%
2	ATHEROGENICS INC	1,300,700	24,973,440	3.5%	4.7%
3	PHARMACOPEIA INC	825,470	16,195,721	3.5%	0.6%
4	CONNETICS CORP	1,062,512	23,407,139	3.3%	3.5%
5	DENDRITE INTL INC	1,318,529	21,795,284	3.3%	9.3%
6	INCYTE CORP	2,338,495	20,204,597	3.2%	25.1%
7	AZTAR CORP	1,096,753	24,490,494	3.2%	6.1%
8	CV THERAPEUTICS INC	952,610	14,975,029	3.2%	7.4%
9	REGENERON PHARMACEUTICALS INC	1,549,487	22,033,705	2.9%	92.4%
10	KOSAN BIOSCIENCES INC	818,009	9,570,705	2.9%	28.6%
10	NEUROGEN CORP	566,600	4,527,134	2.9%	22.1%
12	SCHWEITZER MAUDUIT INTL INC	395,951	13,204,966	2.7%	13.3%
13	BONE CARE INTL INC	367,980	6,307,177	2.6%	42.0%
14	TITAN INTL INC ILL	530,400	3,129,360	2.5%	14.9%
15	SABA SOFTWARE INC	337,773	1,429,118	2.5%	24.4%
16	GUILFORD PHARMACEUTICALS INC	717,811	5,512,788	2.5%	21.8%
17	ARKANSAS BEST CORP	606,241	16,598,879	2.4%	12.9%
18	CLAIRE S STORES INC	1,115,752	22,560,505	2.4%	11.0%
19	VIROPHARMA INC	590,400	1,853,856	2.3%	50.0%
20	GRACO INC	1,028,117	43,653,848	2.2%	5.4%
21	ARGOSY GAMING CORP	648,014	20,049,553	2.2%	13.0%
22	MOOG INC	330,450	11,873,069	2.2%	16.5%
23	COLLAGENEX PHARMACEUTICALS INC	300,000	3,324,000	2.2%	35.0%
24	NPS PHARMACEUTICALS INC	790,300	23,685,291	2.1%	2.7%
25	ZYMOGENETICS INC	1,087,300	18,060,053	2.1%	68.9%
26	HAEMONETICS CORP MASS	516,564	14,975,190	2.1%	14.9%
27	BANCFIRST CORP	160,940	9,286,238	2.1%	60.4%
28	MEDICINES CO	959,348	26,055,892	2.0%	25.1%
29	GARTNER INC	2,047,889	23,141,146	2.0%	40.0%
30	A C MOORE ARTS + CRAFTS INC	392,900	8,938,475	2.0%	30.7%
31	GENE LOGIC	627,260	3,581,655	2.0%	3.6%
32	KENDLE INTL INC	261,900	2,435,670	2.0%	17.3%
33	INTERSTATE BAKERIES CORP	894,794	13,421,910	2.0%	1.2%
	Total/Average		487,614,359		22.1%