

## Comment Letter on NYSE Proposed Amendments to Shareholder Approval Policy, December 1998

December 10, 1998

Mr. Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Re: NYSE Shareholder Approval Policy (File No. SR-NYSE-98-32)**

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to express its views on the New York Stock Exchange's ("Exchange") proposed amendments to its shareholder approval policy, which governs when stock option plans should be subject to shareholder approval.<sup>2</sup> Last year, the Exchange adopted amendments to the policy, which, among other things, codified existing Exchange interpretation regarding "broadly-based" plans and codified a non-exclusive safe harbor for plans in which at least twenty percent of a company's employees were eligible, provided that the majority of those eligible were neither officers nor directors (the "Original Proposal"). In response to concerns expressed primarily by the institutional investor community, the Exchange determined to revisit the Original Proposal and solicited comment on the definition of "broadly-based" plan.<sup>3</sup> In July, the Institute, among others, submitted a comment letter on the Original Proposal, which expressed concern about how the Original Proposal would have affected the proper role of shareholders' review of stock option plans.<sup>4</sup> The Exchange established a Task Force to review the comments submitted and make recommendations. Accordingly, the Exchange's current proposal (the "Proposal") reflects the Task Force's recommendations. Overall, the Institute supports the adoption of the Proposal. As discussed below, however, we also recommend that further changes be made to require shareholder approval of those stock option plans that have the potential to significantly dilute shareholders' interests.

The Proposal would define a "broadly-based" plan as any plan in which (1) at least a majority of the issuer's full-time, exempt U.S. employees are eligible to participate under the plan, and (2) at least a majority of the shares of stock or shares of stock underlying options awarded under the plan, during the shorter of the three-year period commencing on the date the plan is adopted by the company, or the term of the plan itself, must be awarded to employees who are not officers or directors of the company. The Release also states that the term "officer" has the same meaning as defined in Rule 16a-1(f) under the Securities Exchange Act of 1934, or any successor rule.

As mentioned, the Institute supports the Proposal and urges its adoption. Indeed, the proposed definition of "broadly-based" plan addresses many of the concerns expressed in our previous letter. For example, the definition reflects the important distinction between employee eligibility and employee participation. It also includes a requirement that at least a majority of shares awarded under a plan be awarded to employees (including both "exempt" and non-exempt employees) who are not officers or directors, in apparent recognition of the importance of implementing a plan in a truly broadly-based fashion.<sup>5</sup> The Institute is also pleased that the Proposal would designate the definition as an exclusive test, rather than a non-exclusive safe harbor. This revision should enhance shareholder protection as it will likely bring greater certainty to the process and remove the temptation for companies to develop additional arguments to avoid having to seek shareholder approval, as might be the case under a non-exclusive safe harbor approach.

The Exchange's approach in developing a workable definition for broadly-based plans is definitely a step in the right direction. Still, more work needs to be done in this area to ensure that those stock option plans that contain features that have the greatest potential for significantly diluting shareholders' interests are submitted for shareholder approval. For example, as our previous letter indicated, some stock option plans are not based directly on company or stock performance or tied to pre-established performance goals. Other

plans provide for the issuance of shares at no cost or at a significant discount to the then-current fair market value (i.e., discounted or restricted stock). Still others, such as evergreen plans, reload option plans, and plans that permit repricing of underwater options or mandate pricing below the market, similarly can have a dilutive effect on shareholders' interests.

Clearly, these potentially dilutive features highlight the need to ensure that such plans receive appropriate shareholder scrutiny, particularly given the unavoidable conflict of interest faced by management as they design such plans. The Exchange's proposal does not address these issues. We are pleased, however, that the Exchange has adopted the Task Force's recommendation that "the Task Force or other appropriate group immediately commence a study to establish a maximum overall dilution listing standard for all non-tax qualified Plans that otherwise would be exempt from shareholder approval."<sup>6</sup> The Institute supports the continued efforts of the Exchange and the Task Force in this area, and we are hopeful that their efforts will result in the development of an overall, workable dilution test. In our view, such a result is necessary to ensure the protection of shareholders' interests. Furthermore, given the complexity of and potential controversy involved in developing such a test, we urge the Exchange to solicit public comment on any test that it develops to ensure that the views of all interested persons are considered.

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The Institute appreciates the opportunity to comment on the Exchange's Proposal. If you have any questions concerning our comments, please contact me at (202) 326-5824 or Barry E. Simmons at (202) 326-5923.

Sincerely,

Amy B.R. Lancellotta  
Senior Counsel

cc: Richard R. Lindsey  
Director  
Division of Market Regulation  
U.S. Securities and Exchange Commission

Stephen Walsh  
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#### ENDNOTES

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,373 open-end investment companies ("mutual funds"), 450 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about \$5.061 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 499 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

<sup>2</sup> SEC Release No. 34-40679 (Nov. 13, 1998); 63 Fed. Reg. 64304 (Nov. 19, 1998) (the "Release"). The Exchange's amended proposal revises its shareholder approval policy with respect to stock option and similar plans.

<sup>3</sup> See NYSE, Inc., Stockholder Approval Requirements for Broadly-Based Stock Option Plans, Request for Comment (June 5, 1998).

<sup>4</sup> See [Letter](#) from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Stephen Walsh, Vice President and Managing Director, New York Stock Exchange, Inc., dated July 9, 1998. Specifically, the letter recommended that because of the many varied permutations available in designing stock option plans, and the potentially dilutive effect such plans and plan amendments can have on shareholder value, shareholders should be given the opportunity to review, evaluate, and vote on all stock option plans that are likely to have a significant dilutive effect on existing shareholders' interests. Alternatively, the letter suggested various modifications to the definition of "broadly-based" plans in the event the Exchange determined to continue its policy of exempting such plans from the shareholder approval requirement.

<sup>5</sup> See Release at 64306, n. 7.

<sup>6</sup> Id. at 64306. The Release adds that the goal would be to complete the study in time for Exchange review prior to the year 2000 proxy statement season. Id.

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