

## Comment Letter on NASD Shareholder Approval Proposal, February 2001

February 5, 2001

Mr. Robert Aber  
Senior Vice President  
The Nasdaq Stock Market, Inc.  
1801 K Street, N.W.  
8th Floor  
Washington, DC 20006

### Re: Shareholder Approval of Stock Option Plans

Dear Mr. Aber:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to express its views on the issue of shareholder approval of stock option plans. Investment companies and private account clients of investment advisers are significant purchasers of shares of companies listed on the Nasdaq Stock Market ("Nasdaq"), the New York Stock Exchange ("NYSE"), and other exchanges, and, as such, have a particular interest in this matter.

Investment advisers, on behalf of their investment company and private account clients, review and cast their votes on thousands of proxy proposals every year, many of which pertain to the creation or amendment of stock option plans. Indeed, shares issued under stock option plans represent an ever-increasing amount of shares outstanding for many U.S. companies.<sup>2</sup> Stock option plans can be beneficial in aligning shareholder and corporate management interests and in furthering corporate stability. If designed appropriately, such plans can enable a company to attract and retain key personnel and provide added incentives for employee investment in the corporation's underlying securities, thereby increasing the potential for maximizing shareholder return. If designed inappropriately, however, stock option plans can have a deleterious effect on shareholder value through the transfer of wealth or voting power from shareholders to corporate management. Such plans can have a dilutive effect on shareholders' equity – or may not be based directly on performance or tied to pre-established performance goals.

Because of these concerns, it has become increasingly important for shareholders to be given the opportunity to review, evaluate, and vote on all stock option plans proposed, or proposed to be amended, by management that could potentially harm their interests. For this reason, the Institute expressed support for a 1998 NYSE proposal<sup>3</sup> to limit its "broadly based" plan exemption to the shareholder approval requirement as a "step in the right direction."<sup>4</sup> We urged further work in this area, however, to ensure that those stock option plans that have the potential to significantly dilute shareholders' interests are submitted for shareholder approval.

In 1999, the NYSE's Special Task Force on Stockholder Approval Policy recommended that the NYSE expand the categories of stock option plans subject to shareholder approval.<sup>5</sup> Specifically, the Task Force recommendations would remove the NYSE's "broadly based" plan exemption, and require shareholder approval with respect to every plan in which officers and directors participated, with very limited exceptions. In addition, the Task Force developed an overall dilution standard for plans that did not involve participation by officers and directors. Under this standard, shareholder approval would be required for most plans, but issuers generally would be permitted, without obtaining shareholder approval, to adopt plans involving no more than ten percent of the potential dilution authorized under shareholder-approved plans.

The Task Force also recommended that the proposed NYSE rule changes take effect "in coordination with, and at the same time as, a substantially similar rule, or another standard which similarly protects investor interests, is approved for the NASDAQ/Amex Stock Markets."<sup>6</sup> The Task Force stated that "coordination of standards is important because, with regard to corporate governance, the leading securities markets should seek to harmonize their rules in the best interests of investors, not to compete on the basis of disparities in their rules which may tend to compromise those interests or undermine the public's confidence and trust in those markets."<sup>7</sup>

The Institute supports the Task Force recommendations. In our view, both the elimination of the "broadly based" plan exemption and the establishment of an overall, workable dilution test are necessary to ensure the protection of shareholders' interests. While we believe the Task Force's specific recommendations would achieve that goal, we are open to the consideration of alternative standards that would provide equivalent rights to shareholders.

We also concur in the Task Force's analysis of the competitive issues raised by its recommendations, and therefore urge Nasdaq to propose and adopt similar (or alternative) rules in coordination with the NYSE. Differing standards for shareholder approval of stock option plans might create a "race to the bottom" as exchanges compete with each other to attract new listings. In addition, we recommend that both the NYSE and Nasdaq solicit public comment on such proposals to ensure that the views of all interested persons are considered in connection with these complex and potentially controversial issues.

\* \* \*

The Institute appreciates the opportunity to comment on these important issues.

Sincerely,

Kathy D. Ireland  
Associate Counsel

cc: Arthur Levitt  
Chairman  
Securities and Exchange Commission

Sara Bloom  
Associate General Counsel  
The Nasdaq Stock Market, Inc.

Catherine R. Kinney  
Group Executive Vice President  
New York Stock Exchange, Inc.

#### **ENDNOTES**

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,433 open-end investment companies ("mutual funds"), 491 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.796 trillion, accounting for approximately 95% of total industry assets, and over 83.5 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 382 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 Nos. 33-7944 and 34-43892 (January 30, 2001), 66 Fed. Reg. 8731 (February 1, 2001) (proposing enhanced disclosure requirements in this area). The release states that the National Center for Employee Ownership estimates that nearly 10 million employees currently receive stock options, up from one million in 1992.

<sup>3</sup> See NYSE, Inc., Stockholder Approval Requirements for Broadly-Based Stock Option Plans, Request for Comment (June 5, 1998). The Securities and Exchange Commission in June 1999 approved the proposed "broadly based" exemption on a pilot basis. SEC Release No. 34-41479 (June 4, 1999), 64 Fed. Reg. 31667 (June 11, 1999). The pilot period is currently scheduled to end on February 28, 2001, but the Commission recently published for public comment a proposal to further extend the pilot period until September 30, 2001, and to amend the definition of "broadly based." SEC Release No. 34-43879 (January 24, 2001), 66 Fed. Reg. 8827 (February 2, 2001).

<sup>4</sup> See Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 10, 1998.

<sup>5</sup> The NYSE noted in a December 2000 letter to its listed companies that its Board of Directors had not yet adopted the Task Force recommendations. See Letter from Catherine R. Kinney, Group Executive Vice President, Competitive Position Group, New York Stock Exchange, Inc., to Corporate Secretaries of Listed Companies, dated December 20, 2000 (available at [www.nyse.com/pdfs/policy.pdf](http://www.nyse.com/pdfs/policy.pdf)).

<sup>6</sup> Report of the NYSE Special Task Force on Stockholder Approval Policy (October 28, 1999) at 18.

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