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August 17, 2009

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

Re: SEC File No. S7-10-09 (June 10, 2009); Release Nos. 33-9046; 43-60089; IC-28765 Proposed Rules under the Securities Act of 1933 and the Securities Exchange Act of 1934 "*Facilitating Director Nominations", 74 FR 29024*

Dear Ms. Murphy:

The American Bankers Association[1] (ABA) appreciates the opportunity to comment on the Securities and Exchange Commission's (SEC or Commission) proposed release on Facilitating Director Nominations (the Release). In the Release, the SEC first has proposed a new rule – Rule 14a-11 – that would, under certain circumstances, require companies to include in their proxy materials shareholder nominees for director submitted by shareholders or groups of shareholders with specified levels of holdings. Second, the Release proposes to repeal Rule 14a-8(i)(8), the "election exclusion." This means that a company would no longer be permitted to exclude a shareholder proposal dealing with the election nomination process unless the shareholder proposal conflicts with the proposed rules. ABA writes in support of the proposed change to Rule 14a-8(i)(8) and in opposition to Rule 14a-11.

Good Corporate Governance Is a Critical Component of Being a Good Bank

ABA and its member banks are committed to adopting sound board governance principles and practices to ensure that bank boards are responsive to all stakeholders

[1] The American Bankers Association brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

and well-equipped to handle the challenges of risk assessment and risk control. Banks are invested in ensuring that all banks have good corporate governance practices to protect the reputation and success of the industry.

We recognize that corporations must continually work to strengthen their governance structures and develop new approaches to oversight and are committed to doing so through education, peer interaction, committee work, and discussions with federal and state regulators to ensure that our nations' banks, both large and small, develop and practice good corporate governance. We appreciate the Commission's work in addressing this important issue; however, we strongly believe that the SEC's proposed Rule 14a-11, which would mandate a one-size-fits-all federal proxy access rule, is neither necessary nor advisable. Instead of mechanically applying a uniform proxy access rule to all corporations, no matter their situation, we prefer respecting the role of state corporate law and the wisdom of our members' shareholders to develop appropriately tailored proxy access bylaws for publicly traded banks. Therefore, we support the SEC's proposed amendment to Rule 14a-8(i)(8) to require companies to include in their proxy materials shareholder proposals providing for an access bylaw.

Amendments to Rule 14a-8 Will Allow Improvements to Board Shareholder Relationships

ABA supports the SEC's efforts to remove impediments to shareholders' ability to exercise their rights under state law to elect directors. However, we are concerned that the SEC's primary mechanism for achieving that goal, amending Rule 14a-11, runs the risk of causing costly unintended consequences and could have perverse and unsafe ramifications for our nations' banks. In particular, the mandated proxy access regime fails to take into consideration the disparate impact it would have on the banking industry which has, as the Commission is aware, a disproportionate number of small "public" companies due to outdated SEC registration and reporting requirements.[2]

There is no need to impose a rigid solution to this problem. Currently, Rule 14a-8(i)(8) permits companies to exclude shareholder proposals that relate to an election for membership on a company's board. Some claim that this rule has blocked shareholders' ability to have a say in the governance of the corporation; however this is not the experience in America's community banks. Community banks are inherently responsive to their shareholders because of their social and banking cross-connections.[3] We believe, however, that an amendment to Rule 14a-8 could "facilitate shareholders and companies working together to tailor companies' governing

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[2] *See* November 12, 2008 Letter from Sarah A. Miller to John W. White and James Overdahl re Updating the Shareholder Threshold for Registration, (ABA's 500 Shareholder Letter). Currently, Section 12(g) of the Securities Exchange Act of 1934 requires a company with $10 million in assets and 500 shareholders to register its securities with the SEC and subsequently comply with the SEC's significant registration and reporting requirements for "public" companies. Ninety-nine percent of all banks have in excess of $10 million in assets (loans), thus the 500 shareholder measure is effectively the sole determinant of whether a bank is a "public" company or not. The cumulative burden on small issuers posed by the numerous regulatory initiatives that have been introduced since we filed our letter has significantly magnified the stresses on small issuers. As we state in our letter, updating the shareholder threshold will help restore the principals of proportionality and balance to our securities laws so that the benefits to the investing public outweigh the regulatory costs to our nations' small businesses.

[3] *See infra* at p. 5-6. While many community banks issue public stock, such stock is largely held by members of the community where the bank operates. These local shareholders often bank where they have invested and more often than not personally know members of the board and management.

documents to suit the specific interests of the company and its shareholders."[4] Such an amendment to Rule 14a-8 could accommodate shareholder choice, avoid conflicts with substantive state law, avoid many institutional costs and uncertainties, and not be subject to the significant legal challenges that face the imposition of a one-size-fits-all proxy regime.

As noted by Commissioner Paredes in his dissent:

> Not only does [an amendment to Rule 14a-8] respect private ordering, but it benefits from not requiring the Commission to assert itself into corporate governance by drawing a number of lines in the way the Commission does to establish eligibility requirements under proposed Rule 14a-11. The Commission is not well-positioned to decide "who is in" and "who is out." Yet under the proposal the Commission will vote on today, shareholders, regardless of their preferences, have no choice but to accept as a federal mandate the lines the Commission draws.[5]

A Federally Mandated Proxy Access Rule Would Infringe on an Area of Corporate Affairs that Is Properly the Domain of State Law

Historically, states have had the unquestioned authority to regulate corporations domiciled within their states, including the voting rights of shareholders and the relationship between boards and shareholders. This authority has allowed states to respond to the particular needs of constituents affected by their laws. The imposition of a single federal rule to govern proxy access for corporations of all shapes and sizes would unnecessarily deprive corporations of the flexibility state law confers to deal effectively with countless different circumstances that the SEC cannot anticipate. It also would halt the effective process of experimentation that goes on in state "laboratories" where states and corporations can experiment with different forms of proxy access to develop best practices and would thereby undermine a valuable element of the state system of corporate governance.

The ABA and its member banks have not had sufficient time to analyze fully the SEC's proposal and identify the many practical implementation issues and unintended consequences that the proposal presents.[6] However, we have identified some particularly problematic issues that we believe need further analysis. While the SEC has mandated these (and other) eligibility requirements, we offer these as examples of how proposed rule 14a-11 would prohibit

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[4] Release at 188.

[5] Commissioner Troy A. Paredes Statement at Open Meeting to Proposed Amendments Regarding Facilitating Shareholder Director Nominations at page 4 (http://www.sec.gov/news/speech/2009/spch052009tap.htm).

[6] As other commentators have pointed out, the comment period provided for in the Release does not provide sufficient opportunity to assess and adequately provide thoughtful commentary on the many significant, complex issues raised in the Release, including the more than 500 questions and requests for data. This compressed time period is all the more insufficient given that it is coming not just during the summer months, when scheduling is often difficult, but also during a time period when many financial institutions are simultaneously trying to digest and comment on an avalanche of new regulatory and legislative proposals designed to reshape fundamentally the regulatory landscape. Therefore, while we have prepared a general response to the Release, we believe that affected organizations and other stakeholders deserve a much fuller time period to debate the merits of the SEC's Release and that the SEC would be acting without an adequate record if it adopted proposed rule 14a-11 without providing an opportunity for further analysis and comment.

shareholders from exercising their state law right to give effect to their preferences as to various eligibility rights in the proxy access context.

Proposed Rule 14a-11 Would Prevent Shareholders from Exercising Preferences as to Eligibility Rights

Ownership Duration and Thresholds. The SEC's proposal conditions proxy access on a level of beneficial ownership that is tied to the size of the corporation (*i.e.,* 1% of the corporation's outstanding voting securities for large accelerated filers; 3% for accelerated filers; and 5% for non-accelerated filers). The rule also conditions access on maintaining ownership for at least one year and certifying that the requisite level of ownership will be held through the annual meeting. ABA is concerned that these ownership thresholds may not be appropriate for all publicly traded banks, many of which do not fit the "profile" of a publicly traded institution.

Simply put, the proposed regime will make it far too easy for activist shareholders with agendas unrelated to the welfare of the corporation and the vast majority of its shareholders to act in a manner that is not in the best interests or the continued safety and soundness of the bank. While these nominees may ultimately be defeated, the fact of the proxy contest will cause the corporation to incur substantial expense, to endure major disruption to its operations, and will create significant confusion for the corporation's shareholders. In the banking context, this shareholder confusion can also have unfortunate ramifications for the perception of the bank's safety and soundness. Banks which have faced election contests report that these contests generate significant confusion and concern among shareholders as to whether the bank is financially stable, even when the election contest is being conducted for purely personal reasons.

Each institution should be permitted to work with its shareholders to determine an appropriate level of ownership for proxy access. Because many community banks have relatively few shareholders, and a shareholder base that is fairly concentrated in the local area, these institutions, working with their shareholders, will seek to determine the correct thresholds based not only on the size of the company, but also the concentration and composition of the company's shareholder base.

Determining Priority Among Nominees. Proposed Rule 14a-11 establishes a "first in" standard of priority where there are more eligible proxy access nominees than the Rule permits. We are concerned that this aspect of the SEC proposal will cause a race to file. There is no logical link to being first in line and the quality or qualifications of the nominees. Shareholders in many corporations might choose to exercise their state law rights to adopt a priority rule based on share ownership.

Uncertainty of Change of Control Exception. We appreciate that the SEC has attempted to fashion its proxy access proposal in a way to prevent it from being used as a means for effecting a change of control by requiring an initial certification that a change of control is not intended. However, we are concerned that in practice, the change of control protection will not work. There is nothing in the proposal to prevent the shareholder or shareholders from having a change of mind, and there is no remedy to the corporation if such change of mind occurs. Shareholders may prefer tougher limitations to prevent the proxy access regime from being used to effect a change of control. Similarly, the SEC proposal permits the use of the rule regardless of whether a change of control contest is otherwise underway. Shareholders may wish to preclude proxy access where such a contest occurs.

Liability concerns. The proposed rules provide that a company will not be responsible for information provided by a nominating shareholder unless the company knows or has reason to know that the information is false and misleading. This "reason to know" standard is often applied in hindsight and its potential for costly litigation will be a cause of concern for many companies faced with a request to include shareholder statements in the company proxy. In order to avoid the practical difficulty of assuring themselves of the accuracy of statements made by nominating shareholders, institutions and their shareholders might choose to provide for a different corporate liability standard or a different mechanism of access for shareholder nominees.

There Is No Need To Impose A Federally Mandated One-Size-Fits All Proxy-Access Rule

The SEC's release justifies the need for its broadly drafted proxy access amendments by stating that the financial "crisis has led many to raise serious concerns about the accountability and responsiveness of some companies and boards of directors to the interests of shareholders and has resulted in a loss of investor confidence."[7] We wish to point out that the current financial crisis has very little to do with shareholder accountability and responsiveness on the part of banks. Rather, the crisis began in the non-banking system (that part of financial services that was not supervised by banking regulators) and was in part supported by various elements of financial structurings. The SEC further states that refining the proxy process so that it functions "as nearly as possible, as a replacement for an actual in-person meeting of shareholders" is important because "the proxy process has become the primary way for shareholders to learn about the matters to be decided by the shareholders and to make their views known to company management."[8]

ABA supports the principle of working to improve corporate governance and shareholder accountability. However, we do not believe that this goal can be achieved through the operation of a one-size-fits all proxy access regime. The corporate governance challenges institutions face vary widely. While some institutions may suffer from a lack of accountability for which mandated proxy access is a possible cure, others may not have an accountability problem at all. For example, many banks—especially community banks—do not have a model of dispersed shareholders who are not able to influence the direction of company.[9] There is no need to mandate a potentially costly and disruptive proxy access proposal (designed for impersonal corporations with large numbers of dispersed shareholders) upon these institutions. The majority of the shareholders of these banks live in the community where the bank operates. They have no problem making their views known to the board, management or other shareholders. Shareholders of these banks come to annual meetings, know bank directors and management,

[7] Release at p. 7.
[8] Id. at p. 9.
[9] *See* ABA 500 Shareholder letter. As noted in the letter, ABA conducted an informal survey of its members interested in the 500 shareholder issue and found that 70-95% of the surveyed banks' shareholders are in state.

and do not hesitate to speak with them when they see them at the local coffee shop, the bank, or in the driveway.

Moreover, the proposal to give shareholders access to the company proxy may have unforeseen consequences, and we urge careful consideration of these possibilities. As an example, trust and fiduciary bankers have questioned whether they could potentially be sued by trust beneficiaries for failing to seek to replace directors on company boards when companies in which the beneficiaries are invested do not perform as well as they have in the past. As the Commission is aware, it is not uncommon for beneficiaries to bring suits against deep-pocket trustees when investments underperform. We are concerned that beneficiaries could allege breach of fiduciary duties if a trust bank did not actively seek to replace directors when a company fails to meet its quarterly projections or some other similar news causes a company's stock to drop.

A Federally Mandated Proxy Access Rule Runs the Risk of Impairing, Rather Than Improving, Corporate Governance at Many Institutions

The process of nominating and establishing a good board of directors for a bank, especially a community bank, is a complex process. Community banks do not have an unlimited supply of ready and willing persons who could capably fill the role of an independent and qualified bank board member. All banks must work hard to recruit qualified candidates and must continually assess potential recruits' areas of strength and ability as well as the banks' areas of need.

Directors of publicly held banks are subject to a complex framework of federal and state banking laws and regulations. Banking laws and regulations have their own standards of eligibility for directors. Bank regulators require banks to file an application or notice with a banking agency before adding a director to the board, and directors of national banks must own capital stock of the association of which he or she is a director.[10] Individuals convicted of criminal offences or subject to cease and desist orders for conduct involving dishonesty or breaches of trust are prohibited by regulation from serving as directors of financial institutions. Individuals that are considered for election as directors of banks must have the expertise and skills to discharge their fiduciary duties in this highly regulated banking industry. Not only do the directors answer to shareholders, they also answer to federal and state regulators. A shareholder nominee may not be fully aware of these responsibilities and duties and may not have the credentials necessary or the desire to perform them in a satisfactory manner. This is particularly true if the shareholder's issue is political or personally focused.

Thus, because the SEC's proposal does not provide a mechanism to ensure that shareholder nominees will satisfy the particular needs of banks or regulatory qualifications to serve, the overall effectiveness of boards of directors may suffer if shareholder nominees defeat board

[10] Twelve U.S.C. § 72 generally requires that "[e]very director must own…capital stock of the association of which he or she is a director the aggregate par value of which is not less than $1,000, or an equivalent interest, as determined by the Comptroller of the Currency, in any company which has control over such association [as determined by the Bank Holding Company Act]." The purpose of the statute is to ensure that a national bank director has a financial stake in the operations of the bank (or its parent company) so that the director will have the incentive to be vigilant in protecting the bank's interests. *See* OCC Interpretive Letter No. 83 (March 29, 1979), citing *Cupo v. Community National Bank and Trust Company*, 324 F. Supp. 1390 (E.D.N.Y. 1971).

nominees who meet the complex regulatory needs of the organization and have the particular expertise or experience needed by the board. Such elections could put the bank at regulatory risk if, for example, a shareholder nominee defeats the bank's audit committee's financial expert and causes the bank no longer to be in compliance with the Sarbanes-Oxley Act. Moreover, our members are concerned that if a bank is required to include shareholder nominees in its proxy materials qualified nominees could be ill-equipped and unmotivated to participate in a campaign that pits them against a professional activist shareholder nominee.

We are particularly concerned with shareholder director nominees and access to the proxy process as it relates to mutual institutions and community banks. Mutual institutions may be discouraged from converting to stock form out of concern that the proposed federal proxy access regime will provide investors having narrow self-interests with additional leverage to force a sale or merger of these institutions after conversion. Likewise smaller community banks may seek to go private, or choose never to go public because of the additional leverage this proposal will provide to special interest shareholders. Activist shareholders are often looking only to receive quick immediate gains from their stock ownership. They are not concerned with either the safety and soundness or the long-term governance of the institution. There is no guarantee that shareholders using proxy access will act in a manner that is beneficial to all shareholders.

Corporate governance and shareholder welfare also may suffer from the imposition of proxy access, because an increased number of proxy contests will be a significant drain on corporate resources and on the ability of boards to manage and oversee bank operations optimally. This is especially true for smaller corporations that do not have the luxury of large corporate communications staffs. Community banks will be required to hire outside consultants and lawyers to manage the increased complexity of the proposed proxy access regime. Moreover, the executive level employees and the board will be required to spend significant time and resources attending to proxy contests rather than on the day-to-day operations of the bank. Not only will the diversion of management time be costly for the bank, but proxy fights often deplete the annual earnings of community banks that go through them. While this may be tolerable under certain circumstances, such as where there has been a triggering incident calling into question the management of the corporation, in many instances these contests will be nothing more than a drain on the resources of the corporation.

Conclusion

In summary, we do not believe that a mandatory federal proxy access regime is necessary or advisable. We urge the SEC not to adopt proposed Rule 14a-11. Instead, we support amending Rule 14a-8 to allow for a private ordering approach to proxy access. ABA appreciates the opportunity to offer our comments on the proposed rules regarding shareholder proxy access. If you have any questions concerning the issues raised in this letter, please do not hesitate to contact the undersigned.

Sincerely,

Carolyn Walsh

Carolyn Walsh