



**STATE BOARD OF ADMINISTRATION
OF FLORIDA**

**1801 HERMITAGE BOULEVARD
TALLAHASSEE, FLORIDA 32308
(850) 488-4406**

**POST OFFICE BOX 13300
32317-3300**

**CHARLIE CRIST
GOVERNOR
AS CHAIRMAN
ALEX SINK
CHIEF FINANCIAL OFFICER
AS TREASURER
BILL McCOLLUM
ATTORNEY GENERAL
AS SECRETARY
COLEMAN STIPANOVICH
EXECUTIVE DIRECTOR**

February 5, 2007

The Honorable Christopher Cox
Chairman
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: DISCLOSURE OF COMPANY RECORD DATE AND BALLOT INFORMATION

Dear Chairman Cox:

I am writing to thank you for your recent comments published on January 26th in the Wall Street Journal concerning the need for regulatory intervention on behalf of shareholders in the securities lending market. The SBA manages the Florida Retirement System (FRS), the fifth largest public pension plan in the United States with approximately \$130 billion in assets, on behalf of more than 970,000 beneficiaries. I also ask you to consider a proposal of increased disclosure for achieving investor protection in this market, and I will highlight what we believe are some of the most concerning aspects in the present securities lending market.

Like other large institutional investors, we frequently lend securities as a method of increasing the returns to our beneficiaries, in accordance with our fiduciary duty. These securities are not typically traded due to our mostly passive management mandate, and such lending activity provides incremental income to the fund due to the large size of our holdings. On average, nearly 10 percent of our equity holdings are out on loan at any given time. Such loans average 40 percent of our shares in each individual company position.

When our holdings are placed on loan, the borrower becomes the legal owner of record. In the event a company sets a record date for a shareholder meeting during the term of the loan, the borrower has the right to cast the vote. Unless the shares are recalled before or on the record date, the SBA effectively forfeits its right to vote.

At the SBA, we believe good corporate governance is essential to protecting our investments and providing better returns to our beneficiaries. As a large institutional investor, we play an essential monitoring role in the market over company boards of directors and management. There are times when the ability to vote has the potential to improve these governance systems or even directly make an impact on the strategic future of the firm, such as with mergers. We take our fiduciary responsibility to vote shares with great seriousness and proxy votes are treated as important assets of our pension fund.

As fiduciaries, we must weigh the value of retaining voting rights against the value of potential lending income and make the decision that will result in the most value to the fund. We believe it would be imprudent to forgo all securities lending in an effort to completely protect our voting rights. Indeed, many loans are made that do not result in the loss of any voting privileges. Some loans that impair our ability to vote affect annual and special shareholder meetings that have no ballot items with significant voting value. In these scenarios, the amount of lending income exceeds the value of the vote. We would prefer the lending income in these circumstances.

But for some meetings, we would prefer to retain the right to vote on what we consider to be important ballot items, those that in our analysis have a value that exceeds the cost of forgone lending income. These ballot items range from those that confer control of the company, such as proxy contests or mergers, to those that guide the adoption of crucial company policies, corporate charter amendments or bylaws, and incentive compensation plans of firms that are now so prevalently discussed in the financial and popular press.

There is one glaring problem with execution of this analysis: we are not privy to the record date before it passes; therefore, we lack the knowledge necessary to recall shares on loan before the record date and allow us to retain the right to vote in the most important corporate elections. Our loan contracts clearly give us the legal option to recall shares, but by the time we are aware of an important meeting, especially an unpredictable one such as a special meeting for a merger, it is simply too late to recall.

We have studied the SBA's loans over the record dates of meetings with significant voting items. We have found evidence that the shares on loan are abnormally high around 'contested' or important meetings. There is also convincing academic literature that addresses the subject and concludes that some entities are using the lending market as a method of wielding disproportionate voting power. We believe that some market participants are capitalizing on the lack of disclosure of ballot items prior to the record date.

Although the SBA and most investors do not have ballot-item information before the record date, some parties do. When an entity presses a corporation for a proxy contest, they can, and in some cases have been documented to, borrow shares to increase their voting power. Since the other investors are not aware of this upcoming event, they lend shares without the knowledge that they are transferring the right to an important vote. These entities are using inside or private information to profit at the expense of other investors. This is a hallmark of the need for investor protection. We believe that ***record dates and ballot items should be publicly disclosed some minimum period of time before the record date. This is critical for shareowners to properly exercise voting rights.*** Only then will shareholders be on equal footing with those who currently possess private or inside information and be able to make lending decisions with adequate information.

This practice has potential to disrupt the legitimacy of corporate votes, which only increases with the rapid growth in this market. Major stock exchanges reported nearly six years ago that loan balances totaled 1.7 percent of market capitalization, and the levels have grown since. Research by Gene D'Avolio indicates that only seven percent of lending capacity is utilized, which means 25 percent of U.S. market capitalization may be available for borrowing.¹ If shareholders aren't informed of upcoming votes, the outcome could be determined by those with an incentive to destroy corporate value, not create. If it seems that it would be too expensive to buy votes that would impart significant voting ability, the low price of average borrowing may convince otherwise; 91 percent of stocks cost less than one percent per annum to borrow, with a mean fee of just 17 basis points.² The fees tend to be lower for larger market capitalization stocks and a high degree of institutional ownership.³

Recent academic literature shows essentially no difference in the cost to borrowers (thus income to sharelenders such as ourselves) whether the borrowed shares result in the right to cast a vote at a shareholder meeting or not.⁴ I do not believe shareholders are 'giving away' their votes because they find them worthless or, as has been suggested, because they don't know how to cast them; they are most likely

¹ See "The Market for Borrowing Stock" by Gene D'Avolio, February 2002.

² Ibid.

³ Ibid.

⁴ See "Vote Trading and Information Aggregation" by Christoffersen, Geczy, Musto, and Reed, January 2005.

The Honorable Christopher Cox

February 5, 2007

Page 3

essentially free because the shareholder didn't know the record date and failed to adjust their supply and expectations for the price of the loan accordingly.

Investors need protection in the form of timely meeting and ballot information. We would find this information to be as important in making financial decisions as any other required in public filings. We ask that you research this issue further to find the best methods of protecting investors and that you seek comment on the inherent problems and processes of securities lending. In a wider context, we also request that you look into allegations of vote discrepancies at shareholder meetings, including "overvoting," which has been reported to be a prevalent problem at some brokers and investment banking institutions. These are opaque practices that threaten the shareholder franchise, a cornerstone of effective corporate governance. Securities lending serves a legitimate market function, but it, as well as overvoting, may be contributing to subversion of the shareholder vote and threatens great potential harm to shareholders.

As suggested by researchers, we believe part of the problem could also be addressed through current disclosure form modifications to reveal economic *and* voting interest.⁵ It is well known that certain hedge funds can use sophisticated means to increase voting power without commensurate economic exposure, and presently there are no requirements to disclose these activities.⁶

We urge you to give investors access to information that will mitigate the use of securities lending markets for vote manipulation. All investors, but particularly large, passive institutions that are disproportionate participants in the securities lending market, are in need of company meeting and ballot item detail before the record date.

We hope that the Commission will take action on this important issue and help investors protect themselves with information. As you have noted, "This is already a serious issue and it is showing all signs of growing." We agree and hope that you will contact us if we can provide information or opinions necessary to your review of this matter. Please feel free to contact Mike McCauley, Director of Investment Services and Communications, at (850) 413-1252 or me.

Sincerely,

Coleman Stipanovich
Executive Director

cc: Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Kathleen L. Casey
Commissioner Annette L. Nazareth
Mr. John Thain, New York Stock Exchange

⁵ See "Empty Voting and Hidden Ownership: Taxonomy, Implications, and Reforms" by Henry T.C. Hu and Bernard Black, April 2006.

⁶ In an article written for the issuer community, Paul Schulman of The Altman Group notes, "There are also procedures involving stock loans or hedging that hedge funds can employ to boost their voting power beyond that represented by the shares they own. Do you know how these mechanisms work?" Chucking Your Toolkit, November 2006.