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Business lobbies seek curb on hedgies

Coalition wants voting rules tightened for non-beneficial owners

By Nicholas Rummell

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A coalition of business and investor relations groups hopes to reduce the influence that hedge funds and major proxy advisory and tabulation firms have over shareholder votes.

The coalition, which includes the Business Roundtable, the National Association of Corporate Directors and the National Investor Relations Institute, has raised a number of concerns about proxy voting, noting that hedge funds and other large shareholders are able to use short sales and cash-settled equity swaps to influence votes without having a beneficial interest in companies. At the same time, the coalition complains that Securities and Exchange Commission rules allow these investors to hide their positions. It also cited as problematic the virtual monopoly that Broadridge Financial Solutions holds in handling proxy voting and shareholder communications, and the oligopoly of proxy advisory services that influence or control a significant number of shares.

None of these complaints are new. Broadridge caught flak earlier this year after botching a proxy vote at Yahoo and has been cited by many as being too powerful. Cash-equity swaps caused concerns after a high-profile proxy fight this summer involving hedge funds that used the swaps to vote undisclosed shares at railroad company CSX. And RiskMetrics and other proxy advisory firms have come under fire for wielding too much influence with their vote recommendations.

The coalition's chances of success are unclear, however. While many corporate governance experts expect action on proxy issues next year by the SEC or Congress, which could involve updating disclosure rules, investor advocates' desire to be given the right to nominate directors may also gain traction if Democratic control of Congress is strengthened and Democratic presidential hopeful Barack Obama wins the election.

The coalition sent a letter earlier this month to the House Financial Services Committee, which has been taking the lead in considering changes to the financial services regulatory system. In the letter, the group called on the SEC to institute a comprehensive evaluation of the proxy system.

"Especially now, during this economic crisis, issuers must be able to communicate directly with all of their owners," said David Smith, president of the Society of Corporate Secretaries and Governance Professionals, noting that such changes should be a priority in 2009 for Congress and the next administration.

"You can rest assured that these proxy issues won't be going away," said Jeffrey Morgan, president of NIRI. He noted in particular that the virtual monopolies held by Broadridge and RiskMetrics are unhealthy. If competitors don't challenge those firms, he suggested that they be made to improve their transparency and shed additional services that have led to conflicts of interest.

RiskMetrics has recently made process changes to improve its transparency, but still offers both governance ratings and advisory services intended to improve such ratings. Such a dual business model presents conflicts of interest, critics say.

Some changes may already be in the works for short-selling and share lending. The California Public Employees' Retirement System earlier this fall stopped lending out shares for the purpose of short-selling. NYSE Euronext officials have said they are considering new curbs to prevent manipulative short-selling. And the jury is out on whether the SEC will reinstate its uptick rule or propose any other regulations to curb abusive short selling.

The coalition also seeks lesser changes to the proxy system that could be made immediately. For example, in its letter to the House, the group asked the SEC to eliminate the distinction in proxies between non-objecting beneficial owners and objecting beneficial owners.

Under current rules, brokers and banks can release contact information only for non-objecting shareholders, which companies see as a hindrance to communications with beneficial owners.

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