

## COMMENT LETTER

November 5, 2003

# Letter on New Amex Rule Requiring Shareholder Approval of Equity Compensation Plans (pdf)

November 5, 2003 Mr. Jonathan G. Katz Secretary Securities and Exchange Commission 450 Fifth Street, N.W. Washington, D.C. 20549 Re: Notice of Filing of Proposed Rule Changes by the American Stock Exchange (File No. SR-Amex-2003-42) Relating to Shareholder Approval of Stock Option Plans Dear Mr. Katz: The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the American Stock Exchange proposal to require shareholder approval of equity-compensation, or stock option, plans and any material revisions of those plans.<sup>2</sup> We strongly support this proposal. The Institute has long been an advocate of requiring shareholder approval of stock option plans. <sup>3</sup> We believe that stock option plans can be beneficial by aligning shareholder and corporate management interests and in furthering corporate stability. Indeed, if properly designed, such plans can enable a company to attract and retain key personnel, and provide incentives for employees to work hard to increase a company's value, thereby increasing the potential for maximizing shareholder return. On the other hand, many stock option plans have a potentially harmful effect on

<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,672 open-end investment companies ("mutual funds"), 603 closed-end investment companies, 107 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.946 trillion, accounting for approximately 95% of total industry assets, and over 90.2 million individual shareholders.

<sup>2</sup> Securities Exchange Act Release No. 48610 (October 9, 2003) [68 FR 59650 (October 16, 2003)] ("Release"). The Securities and Exchange Commission simultaneously solicited comments on Amex's proposed rule change and approved that proposal on an accelerated basis.

<sup>3</sup> See Letter from Dorothy M. Donohue, Associate Counsel, Investment Company Institute, to Mr. Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated November 1, 2002; Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Mr. James L. Cochrane, Senior Vice President, New York Stock Exchange, Inc., dated July 19, 2002; Statement of Investment Company Institute to the NYSE Corporate Accountability and Listing Standards Committee (Matthew P. Fink, President) (May 17, 2002); Letter from Amy B. R. Lancellotta, Senior Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated December 10, 1998; 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; Letter from Kathy D. Ireland, Associate Counsel, Investment Company Institute, to Mr. Robert Aber, Senior Vice President, The Nasdaq Stock Market, Inc., dated February 5, 2001. Jonathan G. Katz

November 5, 2003 Page 2 shareholder value through the transfer of wealth and voting power from shareholders to corporate management. Some stock option plans, for example, provide for the issuance of shares at no cost or at a significant discount from the then-current fair market value. Other plans permit the repricing of so-called "underwater" options to current market value without prior shareholder approval. Still other plans, such as "evergreen" plans, can have similar dilutive effects on shareholder value.<sup>4</sup> The popularity of stock option plans and the potentially dilutive effect that they can have on shareholder value underscores the need to ensure that these plans receive appropriate shareholder scrutiny. This is critical given the conflict faced by corporate management as they formulate such plans. Requiring that shareholders be given the opportunity to express their view on whether a particular stock option plan should be implemented will help to assure that corporate management's decisions regarding these plans are aligned with their shareholders' best interests. Therefore, the Institute strongly supports these proposals. We also are pleased that the Amex proposal is virtually identical to NYSE and Nasdaq rules recently approved by the SEC.<sup>5</sup> Such a coordinated approach ensures that the self-regulatory organizations do not compete on the basis of differences in their rules, encouraging a "race to the bottom" to attract new listings, to the ultimate detriment of investors. \* \* \* \* We appreciate the Commission's consideration of our comments on this important proposal and look forward to commenting on other aspects of Amex's corporate governance proposals when they are published for comment. If you have any questions or need additional information, please contact me at (202) 218-3563. Sincerely, Dorothy M. Donohue Associate Counsel

4 Evergreen plans, in which a nominal percentage of shares outstanding are reserved for award each year, can be dilutive because, among other things, the number of shares issued can increase annually depending on the number of shares outstanding. Under the Amex proposal (like the NYSE and Nasdaq rules), an automatic increase in the shares available under a plan pursuant to a formula set forth in the plan will not be considered a revision if the term of the plan is limited to no more than ten years. It is our understanding that most evergreen plans already are limited to a term of ten years. Therefore, the practical effect of the Amex proposal is to permit existing evergreen plans to increase the shares available for the remaining term of the plan (which can be up to ten years) without obtaining shareholder approval for the increased shares. We urge the Amex to revisit this issue and to view an automatic increase in the shares available under an evergreen plan to be a material revision of the plan that must be submitted for shareholder approval.

5 See Securities Exchange Act Release No. 48108 (June 30, 2003) [68 FR 39995 (July 3, 2003)] and Securities Exchange Act Release No. 48627 (October 14, 2003) [68 FR 60426 (October 22, 2003)]. Jonathan G. Katz November 5, 2003 Page 3 cc: Claudia Crowley Vice President, Listing Qualifications American Stock Exchange LLC Annette L. Nazareth Director Division of Market Regulation Securities and Exchange Commission Mr. James L. Cochrane Senior Vice President New York Stock Exchange, Inc. Ms. Sara Bloom Associate General Counsel The Nasdaq Stock Market, Inc.