American Federation of Labor and Congress of Industrial Organizations

815 Sixteenth Street, N.W.
Washington, D.C. 20006
(202) 637-5000
www.aflcio.org

January 10, 2005

BY ELECTRONIC AND U.S. MAIL

Barbara Z. Sweeney
Office of Corporate Secretary
NASD
1735 K Street, NW
Washington, DC 20006-1500

Re: Comment on Proposed Rule to Address Fairness Opinion Conflicts of Interest

Dear Ms. Sweeney:

On behalf of the American Federation of Labor and Congress of Industrial Organizations, I welcome this opportunity to offer our comments on the National Association of Securities Dealers ("NASD") proposal to enhance disclosure of conflicts of interest in fairness opinions provided by investment banks in corporate control transactions. The request for comment seeks input on "the best way to improve the processes by which investment banks render fairness opinions and manage the inherent conflicts."

We commend the NASD for proposing rules to enhance disclosure of the conflicts inherent to many fairness opinions. While we generally support the rule as proposed, we encourage the NASD to strengthen its proposal by including an outright ban on the most egregious conflicts, notably arrangements in which part of an investment bank's fee for rendering its opinion is contingent upon the transaction closing. We do not believe the mere existence of a business relationship with a company should disqualify an investment bank from providing a fairness opinion, but as detailed below we do find the conflict inherent to contingent fee arrangements sufficiently serious to compromise the integrity of the resulting opinion.

The AFL-CIO is the federation of America's labor unions, representing more than 60 national and international unions and their membership of more than 13 million working women and men. Union members participate in the capital markets as individual investors and through a variety of benefit plans. Union members' benefit plans have over $5 trillion in assets. Union-sponsored pension plans account for over $400 billion of that amount.

I. Background

The stakes involved in corporate control transactions are extremely high for shareholders, as well as for executives and employees. Moreover, the interests of executives responsible for retaining investment banking services in connection with a transaction can differ from those of shareholders given, for example, the prevalence of excessive executive severance arrangements. Given such high stakes and competing interests in a transaction, the integrity of the fairness opinion on which the board and shareholders rely becomes paramount.

Corporate scandals at companies like Enron, Worldcom and Fannie Mae provide painful reminders of the consequences for investors when executives sacrifice long-term value creation for short-term gain. These scandals also taught investors that the very people responsible for protecting our interests—boards of directors, outside auditors, sell-side analysts and mutual fund managers—can be compromised by the unregulated conflicts of interest that permeate their relationships with corporate executives.

In response, we have seen significant regulation over the past several years. In some cases, regulators have chosen to enhance the transparency of the business relationship responsible for a particular conflict. In response to a petition from the AFL-CIO, for example, the Securities and Exchange Commission adopted rules requiring mutual funds to disclose their proxy votes at portfolio companies to address the conflict that arises out of mutual fund companies' desire to sell financial services to the same companies at which they vote proxies on behalf of investors.

In other cases, regulators have deemed a particular conflict sufficiently serious to warrant an outright ban on the activities that give rise to it. The Sarbanes-Oxley Act of 2002, for example, prohibits accounting firms from providing certain non-audit services to their audit clients, and the NASD itself has adopted listing standards that prohibit conflicted directors from sitting on key committees of the boards of directors of listed companies.

In our view, many of the conflicts of interest that investment banks face in providing fairness opinions can be adequately addressed through greater transparency, as the NASD now proposes. Certainly, we believe any significant fee relationship between a company and the investment bank rendering an opinion for that company's board of directors should be disclosed. However, we believe certain conflicts are sufficiently serious to compromise the integrity of the resulting fairness opinion. In particular, we question how any board of directors can rely on a fairness opinion provided by an investment bank when the lion's share of that bank's fee is contingent on the underlying transaction closing.

Moreover, while fairness opinions are provided for the benefit of the board, investors often rely on them as part of their transaction evaluation. We note our own experience with the fairness opinion provided to the MONY Group board by Credit Suisse First Boston in support of AXA Financial Inc.'s proposed $1.5 billion acquisition of MONY announced in September 2003. As proposed, AXA's $31 per share offer represented a 6% premium to MONY's closing price the day prior to the deal's announcement, and was actually 25% below book

value. According to Keefe, Bruyette & Woods Inc., the valuation was among the lowest paid for a U.S. life insurance company.

In determining that the price was fair to MONY shareholders, CSFB marked down MONY's assets, relying on the views of MONY managers who stood to gain $90 million in total severance payments if the deal closed. CSFB also stood to gain if the deal closed, since it would trigger a $15 million contingent fee payment.

Our concerns with CSFB's independence coupled with our skepticism of the merits of the underlying transaction were among the factors that we cited in urging MONY shareholders to vote against the deal during an investor forum hosted by Institutional Shareholder Services on February 4, 2004. In the end, the controversial deal was narrowly approved by 53% of MONY's shareholders, which was sufficient to trigger the $ 15 million contingent fee to CSFB and generous payouts to MONY executives.

II. Summary and Recommendation

As we noted above, the stakes involved in corporate control transactions are extremely high for shareholders, as well as for executives and employees. Given such high stakes and potentially competing interests between executives and shareholders in a particular transaction, the integrity of the fairness opinion on which the board and shareholders rely becomes paramount. Unfortunately, the integrity of fairness opinions provided by investment banks can be compromised by conflicts of interest.

We therefore support the rules proposed by NASD to require disclosure of material fee relationships as well as of the procedures followed by investment banks to verify information and guard against conflicts in the rendering of fairness opinions. We believe the proposed rule would generally provide the information necessary to enable investors to evaluate the integrity of the resulting fairness opinions. At the same time, however, we encourage the NASD to strengthen its rule by prohibiting arrangements in which part of an investment bank's fee for rendering its opinion is contingent upon the transaction closing. Given the seriousness of the conflict inherent to these contingent fee arrangements, we believe an outright ban is warranted.

We thank you for this opportunity to comment on this proposal, and hope that the NASD will consider our comments in formulating its final rule. If you have any questions regarding our comments, please feel free to contact me at (212) 661-1555 ext 15.

Sincerely,

Michael I. Garland
Corporate Transactions Coordinator
AFL-CIO Office of Investment