

Proxy Mechanics

Discussion Paper: Comparison of Existing and Proposed Market Mechanics

Date: May 3, 2010

Version 1.0

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INTRODUCTION

Objectives of This Document

- › Educate stakeholders about the operational aspects of the recommendations made by the Shareholder Communications Coalition (SCC)
- › Review the existing proxy process and propose changes that will improve transparency and end-to-end auditability, including the creation of a low-cost utility function to serve as a central data aggregation entity for beneficial owner data, referred to in this document as the “Hub”
- › Show how changes to the process can increase voting by beneficial owners and registered owners, and how to provide confirmations to the owners that the vote was recorded
- › Outline a framework that would allow for a competitive environment with rates determined by market factors and that would provide corporate issuers with a greater level of access to all their shareholders

Please note: This document does not describe the problems with the existing system in full detail. Please refer to the analysis in Appendix A for a complete description.

SCC's Recommendations

The goal of the SCC's recommendations is to streamline the proxy process to provide issuers with the ability to communicate directly with *all* their shareholders.¹ These changes will result in a proxy system that provides issuers with transparency of their shareholder base, choice of service provider, ability to negotiate fees and services, and greater integrity of the voting process.

Below are the specific issues addressed by the recommendations the SCC sent to the SEC on 8/4/09:²

1. Investor education
2. Non-objecting beneficial owner (NOBO) and objecting beneficial owner (OBO) classification
3. Competition among proxy service providers
4. Beneficial owner list compilation
5. Proxy vote counting and tabulation
6. Beneficial owner proxy authority
7. Integrity of the proxy voting process

¹ With the exception of those who choose to maintain anonymity through custodial or nominee accounts.

² See Appendix A for the full SCC letter.



PROCESS ANALYSIS

SCC's Recommendations: Key Failure Points of the Existing System, Areas That Need to Be Reviewed, and Recommendations

Issue Identified by SCC:	Key Failure Points of the Existing System:	Proposed Process Changes:	Benefits:
1. Investor education	<ul style="list-style-type: none"> › Beneficial owner and registered holder investor education is extremely limited. 	<ul style="list-style-type: none"> › Launch a national investor education campaign. › Note: The SEC has already taken steps to address this issue, such as amending the "notice and access" rules, developing a page on its website devoted to proxy-related questions, and listing new shareholder voting rules. 	<ul style="list-style-type: none"> › Investor awareness of the importance of proxy voting would increase.
2. NOBO/OBO classification	<ul style="list-style-type: none"> › NOBO/OBO classification prevents issuers from communicating directly with all their shareholders. › There is no disclosure of foreign beneficial owners. 	<ul style="list-style-type: none"> › Re-evaluate and eliminate NOBO/OBO classification. › Create a nominee/custody arrangement for holders who wish to remain anonymous.³ 	<ul style="list-style-type: none"> › Issuers would gain access to contact information for the majority of their beneficial owners and would be permitted to communicate with them directly. Shareholders and institutions that choose to register their shares in nominee name could still maintain their anonymity.

³ Currently, European depositaries do not regularly distribute proxy notices to correspondent banks. It is unclear whether the SEC has any authority to require further notification and disclosure. There is no new or additional disclosure of foreign beneficial owners proposed.

SCC's Recommendations: Key Failure Points of the Existing System, Areas That Need to Be Reviewed and Recommendations (cont.)

Issue Identified by SCC:	Key Failure Points of the Existing System:	Proposed Process Changes:	Benefits:
3. Competition among proxy service providers	<ul style="list-style-type: none"> › Issuers do not have a choice of which beneficial owner proxy service provider to use and have no effective leverage in negotiating fees. › Issuers may have to use multiple providers (e.g., transfer agents, beneficial owner proxy service providers, solicitors, plan administrators, printers) for different parts of the process, thereby increasing costs. › Current structure increases risk of process failure (no effective backup if Broadridge's system fails). 	<ul style="list-style-type: none"> › Separate the data aggregation function from proxy distribution and vote tabulation. › Create a low-cost utility function to serve as a central data aggregation entity for beneficial owner data (the Hub). › Ensure that the print/mail and communications distribution cost structure is driven by market factors. 	<ul style="list-style-type: none"> › Issuers would have a choice of agents⁴ in a competitive environment, thereby reducing costs by eliminating redundant processing and having fees set by market forces. › Issuers could communicate more frequently in a cost-effective manner (e.g., quarterly reports), if they are so inclined. › If one agent's system became disabled, the volume could be rerouted to another agent.
4. Beneficial owner list compilation	<ul style="list-style-type: none"> › There is no way to track an individual vote to the end tabulation. › A beneficial owner cannot vote with a voter instruction form (VIF) at a meeting.⁵ 	<ul style="list-style-type: none"> › Provide greater disclosure of beneficial owner positions. › Do away with the VIF and replace it with a proxy card.⁶ › Create a nominee/custody arrangement for holders who wish to remain anonymous.⁷ › Delegate voting authority directly to beneficial owners. 	<ul style="list-style-type: none"> › Distribution and tabulation processes would be uniform for the entire shareholder base. › Every shareholder would be processed as a holder of record, thereby facilitating meeting attendance, auditability of voting results, and vote confirmation. › Householding could be applied across banks/brokers and/or between beneficial owners and registered accounts.

⁴ Under the proposed arrangements, the issuer would select a service provider to act as its agent.

⁵ A voter instruction form is issued by a bank/broker or its intermediary to a beneficial owner. The purpose is to communicate the shareholder's vote instructions to his/her bank/broker so that the vote may be properly cast with the tabulator. In today's system, only the bank/broker can submit votes for beneficial owner shares held in their position at DTCC.

⁶ A proxy card is a voting document issued directly to registered shareholders who appear on the books of the transfer agent. Registered holders are deemed to be legal owners of the shares and can vote directly with the tabulator.

⁷ The Altman Group put together a separate proposal (All Beneficial Owners, "ABO") calling for complete disclosure of all beneficial owner records. If this proposal is approved, a nominee account will not be required.

SCC's Recommendations: Key Failure Points of the Existing System, Areas That Need to Be Reviewed and Recommendations (cont.)

Issue Identified by SCC:	Key Failure Points of the Existing System:	Proposed Process Changes:	Benefits:
5. Proxy vote counting and tabulation	<ul style="list-style-type: none"> › There is a lack of auditability, leading to the inability to track individual votes through to final tabulation. 	<ul style="list-style-type: none"> › Process all shareholder positions in the same manner as registered positions, including vote confirmations. › Require that all brokers' and banks' beneficial owner share positions are reconciled before submission to the Hub. 	<ul style="list-style-type: none"> › End-to-end auditability would be enabled. › Pre-mailing reconciliation of beneficial owner account information would be mandatory. › Greater disclosure of shareholder records would facilitate solicitation efforts.
6. Beneficial owner proxy authority	<ul style="list-style-type: none"> › With the elimination of Rule 452 as it relates to discretionary votes for directors, we need alternative means to encourage beneficial owner voting. 	<ul style="list-style-type: none"> › Enable beneficial owners to give their broker authority to vote in most matters (client-directed voting). › Note: Client-directed voting needs to be reviewed by the SEC. 	<ul style="list-style-type: none"> › The loss of routine broker votes due to the revision of Rule 452 would be offset. › Participation level among retail shareholders would increase.
7. Integrity of proxy voting process	<ul style="list-style-type: none"> › There is a lack of rules and system-wide processes covering the reconciliation process, which can cause over voting. › There is a lack of transparency to issuers of all shareowners. 	<ul style="list-style-type: none"> › Ensure that reconciliation takes place before record date data is transmitted to the Hub. › Delegate voting authority directly to beneficial owners. 	<ul style="list-style-type: none"> › Transparency would be provided, and reconciliation would be facilitated.⁸ › An accurate eligible voter list would be compiled as of record date. › End-to-end confirmation of shareholder votes would be enabled. › Vote counts could be audited by a third party.

⁸ With the exception of those who choose to maintain anonymity through custodial or nominee accounts.

Summary of Benefits of These Changes if Implemented

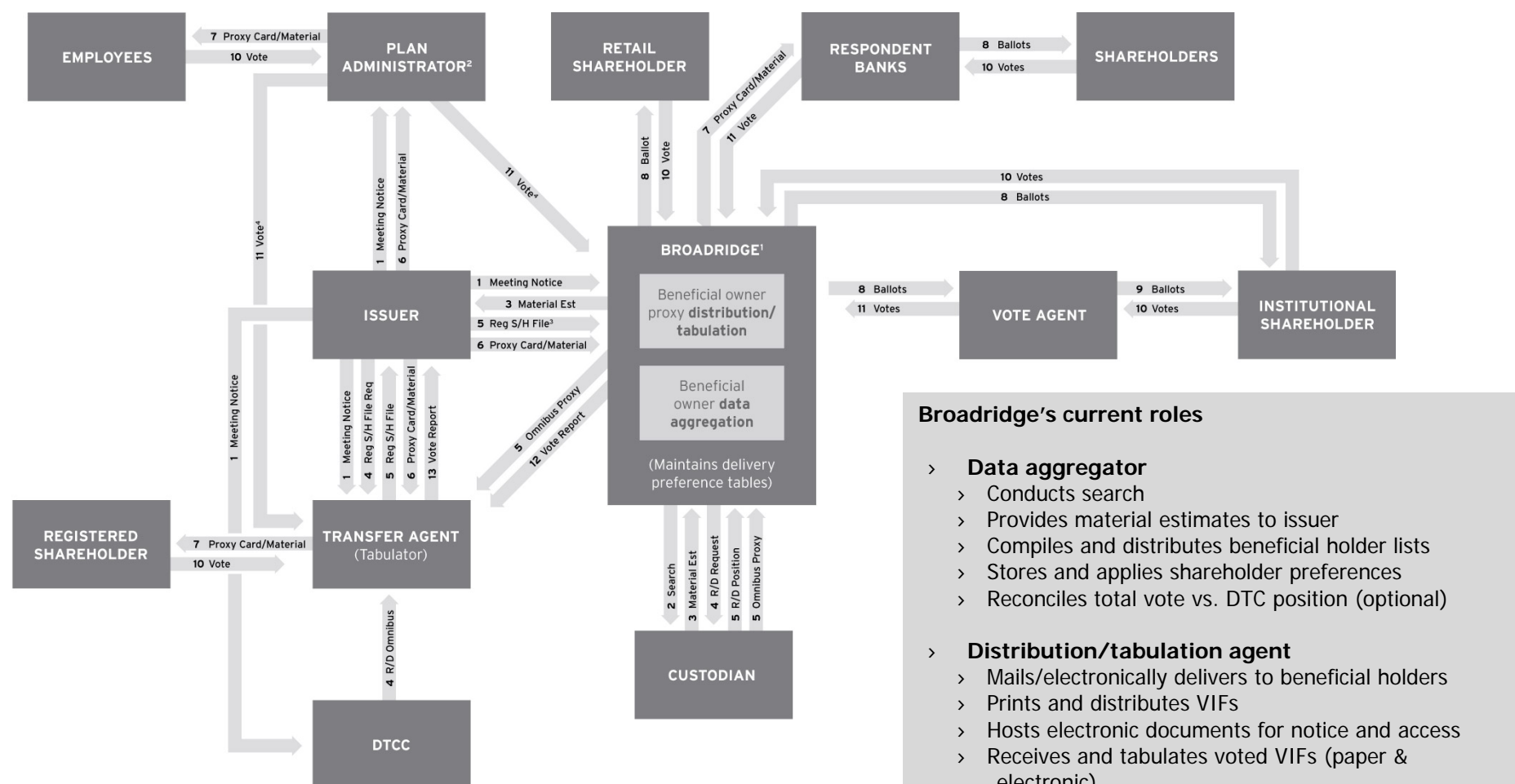
Benefits to Issuers	
Enable direct communication	<ul style="list-style-type: none"> › Control of communications to both registered and beneficial holders, to support key corporate initiatives › Choice of provider based on cost, service, and innovation
Control costs	<ul style="list-style-type: none"> › Choice of best-price provider – greater budget control › Lower costs allow for more frequent communication <ul style="list-style-type: none"> › Enables issuers to reconnect with investors to meet the challenges of the current activist environment
Assure vote accuracy	<ul style="list-style-type: none"> › Auditable, verifiable, transparent voting <ul style="list-style-type: none"> › End-to-end vote confirmation offers assurance that all votes were properly tabulated
Increase voter participation	<ul style="list-style-type: none"> › Education for holders on the importance of their vote <ul style="list-style-type: none"> › Encourages voting by both registered and beneficial owners › Addresses decrease in voting seen with introduction of notice and access

Benefits to Investors	
Meeting attendance	› Replacement of VIF by proxy card to enable beneficial owners to more easily attend and vote at shareholder meetings
Clarity of communications	› Proxy materials and card are customizable and in plain English, providing greater understanding of critical initiatives
Ability to maintain anonymity	› Option for owner anonymity preserved through nominee and custodial accounts
No change for institutional investors	› Changes have no impact on institutional investors already using a vote agent

Comparison of Today's System vs. the Proposed System

> Current system

Note: Arrow numbers indicate chronological process order.



¹ Although Broadridge processes approximately 99% of the beneficial owner volume, there are other entities that perform similar functions

² Could be outsourced to a third party

³ Broadridge may be hired to process registered positions as well

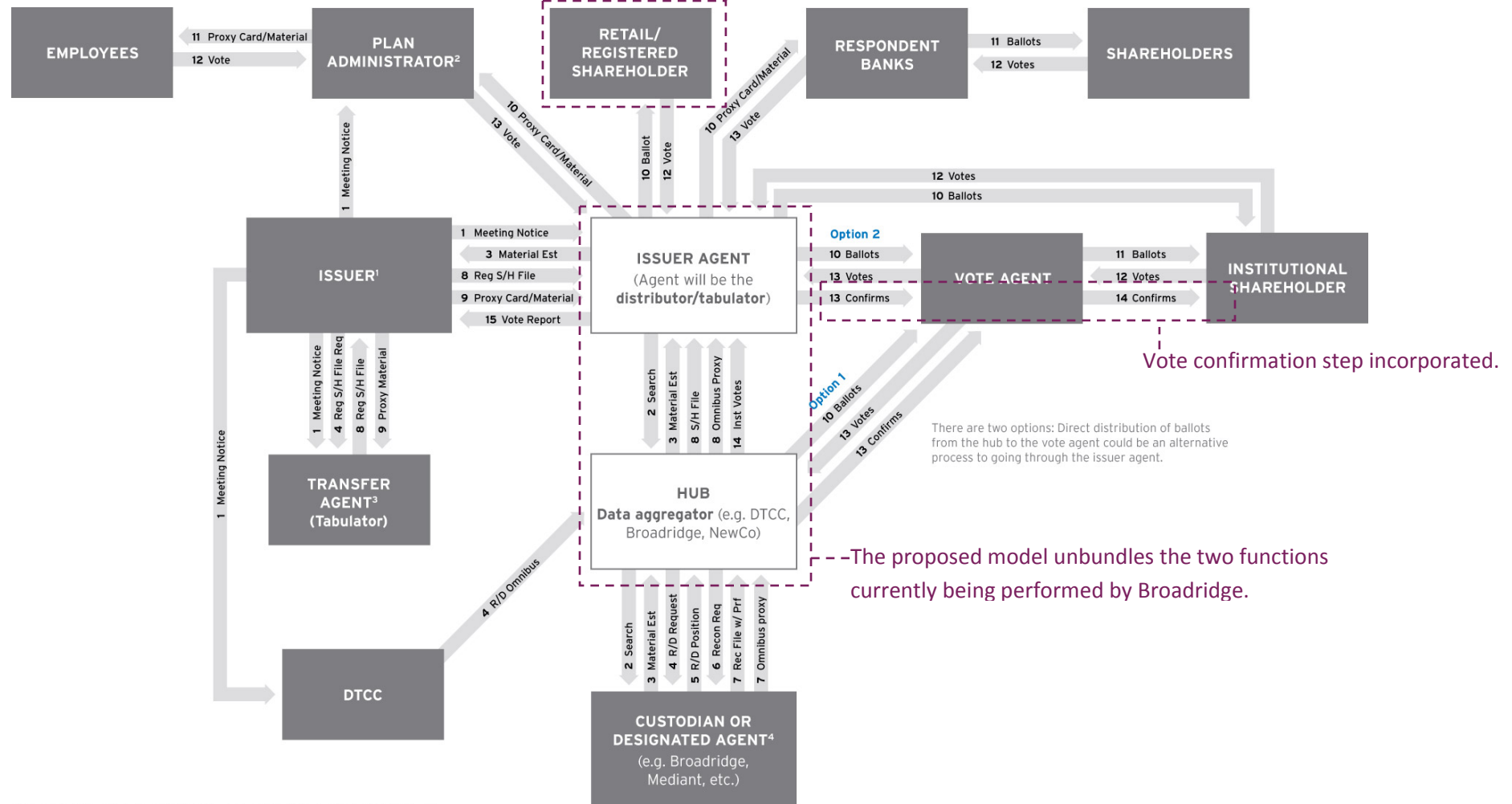
⁴ Employee plan votes can be sent to either Broadridge or the transfer agent depending on the administrator

Comparison of Today's System vs. the Proposed System

> Proposed system

Note: Arrow numbers indicate chronological process order.

Distinction between beneficial and registered holders removed.



¹ Issuer has the ability to choose from various service providers as their agent

² Could be outsourced to a third party

³ Not applicable if transfer agent is issuer agent

⁴ Preferences will be stored at either the custodian or agent level

The Industry Hub – Proposed Terms of Operation

- › The Hub would be a low-cost utility function designed to be a central repository of all beneficial owner positions. Broadridge could become one of several issuer agents competing for distribution and processing business. However, Broadridge could continue to serve as an agent to the bank and broker community.
- › Responses from the bank and broker search⁹ would go to the Hub.
- › The Hub would aggregate the beneficial owner data received from banks and brokers. First, the brokers or their agents would reconcile their own shareholder records to their DTCC position. Then, once the banks and brokers had sent information to the Hub, the Hub would also have a verification process to ensure that the reconciliation was done and would match the aggregate numbers to the DTCC omnibus proxy, which is the record date position for each bank or broker participant.
- › Once the Hub has heard from all the banks and brokers, it will compile and transmit the reconciled file of beneficial owners to the issuer agent. Shareholder delivery preferences (e.g., electronic distribution, “wrap” accounts, “householding” accounts, etc.) would be stored by the bank/broker or its agent. The issuer agent would then load the accounts to the meeting file, similar to any other third-party data file, such as an employee plan participant file.
- › Estimated total of beneficial owner records to be handled by issuer agents would be 250 million.¹⁰

⁹ During the bank and broker search the issuer’s agent or solicitor sends a request to banks and brokers to determine the total number of beneficial accounts, in order to determine how many packets of proxy materials will be needed.

¹⁰ Extrapolated from Computershare data for 2009 annual meetings.

TECHNICAL ASPECTS

Aggregation of Beneficial Owner Information from Market Participants

- › **When?** The bank and broker search would be initiated 20 business days prior to record date. Upon receipt the Hub would aggregate the amounts and report the total to the issuer agent within five business days. On the record date the Hub would send the request to all banks and brokers for shareholder detail records, which would be returned within two business days.
- › **How?** An account number or participant number process would be established in a way similar to the current Broadridge process, so that DTCC participant numbers unique to each bank and broker would be established and linked to the respondent bank process.
- › **What data?** Data would include name, address, TIN, shares, householding code, preference code (electronic or paper), vote agent services (e.g., ProxyEdge, RiskMetrics, etc.), and DTCC participant code.
- › **What formats, etc.?** The existing file format that Broadridge currently uses would be sufficient.
- › **Costs and charges?** Subject to verification by the Hub operator, costs and charges per beneficial owner may be in the range of 1–5 cents per record, paid by issuers or issuer agents.¹¹

¹¹ If under this new model the SEC grants access, others besides issuers or issuer agents may be permitted access to beneficial owner lists and that charge would be paid by those users.

Distribution of Proxy Material by the Issuer's Appointed Agent (401(k), Employee Stock Purchase Plans, Respondent Banks, and Vote Agents)

- › **General principles:** If the recommended changes are implemented, the issuer agent would mail or electronically deliver materials to the registered accounts. The issuer agent would add the files from the aggregator and then mail or electronically deliver a proxy card instead of a VIF to the beneficial owners.
- › **Reconciliations:** Registered holder reconciliation would be done by the transfer agent, and beneficial holder reconciliation would be done by banks and brokers and then validated by the Hub.
- › **Distribution:** Materials would be distributed to all shareholders, including beneficial owners.
- › **Administration by brokers:** Shareholders who assign their voting rights via client-directed voting to brokers would be aggregated and would remain anonymous (replacing the current OBO structure). In addition, some institutional investors may choose to register their shares in a nominee name in order to preserve their anonymity.
- › **Vote agents:** Materials would be distributed to clients of vote agents (ProxyEdge, RiskMetrics, Glass Lewis, etc.).
- › **Formats:** Distribution formats could include paper, as well as email for retail shareholders and electronic access for vote agent clients, etc.).
- › **Special processing:** Preferences (wrap account aggregation, standing instructions, etc.) would be maintained by the bank/broker or its agent and passed to the issuer agent through the Hub.
- › **Respondent banks:**¹² Beneficial owners who hold through a respondent bank could receive a proxy card from the issuer agent or through the bank.

¹² A respondent bank offers securities safekeeping to their clients but does not have its own clearing operation. These banks will typically store their clients holdings in bulk at a major commercial bank while maintaining the individual client records on their own books.

Tabulation (401(k), Employee Stock Purchase Plans, Respondent Banks, and Vote Agents)

- › **Process and formats:** Because proxies would be used instead of VIFs, the vote would be reported in the current custodial format and in the account level format.
- › **Timing:** Current NYSE rules would continue to be applied.
- › **Formats:** Formats could include paper, IVR, web, vote agent, other file transmissions or emails, etc.
- › **Receipts:** Vote confirmations would be sent out for votes obtained over the telephone by solicitors (paper) and vote agent services (electronic).
- › **Reconciliation:** Issuer agent would still have to reconcile votes to the DTCC omnibus proxy.

Data Requirements

- › **Formats:** Potentially four data streams would be required, including files from:
 - › The banks and brokers or their agent(s) to the Hub
 - › The Hub to the issuer agent
 - › The transfer agent to the issuer agent
 - › The Hub to the vote agent

Note: If Option 1 on the proposed system flow (see p. 12) is adopted, then a fifth data stream would be added from the vote agent to the Hub.

Note: Industry-standardized file layouts would need to be developed for these files.
- › **Special requirements:** The bank/broker or its agent would store the shareholder preference data, including the following codes:
 - › Householding (allows combining packages to multiple members of a single household into a single mailing)
 - › Electronic distribution
 - › Proxy vote agent designation
 - › Managed or wrap account aggregation, where voting is delegated to a third-party manager
 - › Full-set delivery for notice and access
- › **Voting timetable:** No changes needed.
- › **Record dates:** System must be able to support multiple record dates.¹³
- › **Capacity requirements:** System would be required to handle an estimated 250 million shareholder records across approximately 13,000 meetings.

¹³ The recent rule change in Delaware provides issuers with the option to set a second record date to capture shareholder data on investors who purchased shares subsequent to the record date. This will also eliminate voting authority for those investors who sold subsequent to record date.

Impact of Change on Key Players in the Market

- › **Hub operator:** The Hub operator may need to establish a new infrastructure, including staff, systems, and management.
Note: If DTCC performs this role, the changes to its systems and operation should be modest.
- › **Broadridge:** Broadridge would become one of several issuer agents competing for the distribution and tabulation business. It could continue to serve as an agent for banks and brokers, and it would continue to operate ProxyEdge as a tool for institutional investors.
- › **Issuer agent:** Agents' infrastructure would have to be upgraded to handle a substantial increase in issuer agents' current volumes. Issuer agents would need to set up a process to provide vote confirmation.
- › **Banks and brokers:** Banks and brokers would transmit beneficial owner position data to the Hub rather than to Broadridge (unless Broadridge is acting as the issuer's agent). The broker or bank would be responsible for a full reconciliation of its beneficial owner share positions to the institution's record date DTCC position.
- › **Solicitor:** The proxy solicitor would receive the full shareholder file from the Hub at the same time the issuer agent received the file. The proxy solicitor would also receive a detailed voting report from the issuer agent.

Impact of Change on Key Players in the Market (cont.)

- › **Vote agents:** Vote agents would receive proxies from and return votes to the Hub. The Hub would also provide vote agents with voting confirmations for their institutional clients.
- › **Inspector of election:** No change.
- › **Investor – beneficial, retail:** Instead of a VIF, retail investors would receive a customizable, plain-English proxy card with full voting and meeting attendance rights.
- › **Investor – registered:** No change.
- › **Investor – institutional:** Institutional investors would receive a verifiable vote confirmation.
Note: Investors would continue to use existing platforms such as ProxyEdge and Votex.

SUMMARY AND NEXT STEPS

Summary

Shortcomings of the existing system:

- › Issuers do not have direct access to a large portion of their shareholder base.
- › The current single-service-provider model lacks transparency and accountability.
- › The distribution process is disjointed and not cost-effective.
- › The lack of auditability and the absence of a confirmation process call into question voting accuracy.

Benefits of the proposed system:

- › It would provide greater disclosure of all shareholder positions.
- › It would establish a multi-service-provider model with greater transparency.
- › It would determine the issuer agent by competitive bidding, and the cost of distribution and tabulation would be determined by market factors.
- › Through expanded availability of electronic communication tools, it would allow issuers to communicate more regularly with their shareholders in a more cost-effective manner. Historically, vote returns were higher when more frequent shareholder communications occurred (e.g., quarterly reports). It would also provide issuers greater access to flexible, innovative communication methods, such as virtual meetings.
- › It would provide full confirmation and auditability.

Key Changes and Next Steps Needed from Major Industry Stakeholders

- › NYSE:
 - › Key changes:
 - › Would no longer be expected to set reimbursement fees.
 - › Revise NYSE rule language to align with revised SEC Rule and removing Rule 465 (reimbursements).
 - › Issue RFP for Hub operator.¹⁴
 - › Next step:
 - › Oversee implementation project plan.
- › SEC:
 - › Next steps:
 - › Repeal the OBO/NOBO rule.
 - › Create a rule mandating that all issuers gain direct access to all their beneficial owners.
 - › Participate in or lead an implementation project team.
 - › Revise SEC rules to make clear:
 - › The obligation of brokers to provide beneficial account information to the issuer agent.
 - › The obligation of the issuers to distribute the communication.
 - › Implement annual audits of the new process.
 - › Establish or reaffirm what communications can take place between an issuer and its holders.

¹⁴ RFP to be issued by NYSE or other appropriate regulatory agency.



**APPENDIX A:
SCC Proxy Mechanics Recommendations
Sent to the SEC on 8/4/09**

August 4, 2009

The Honorable Mary L. Schapiro
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

VIA ELECTRONIC AND
REGULAR MAIL

Dear Chairman Schapiro:

The Shareholder Communications Coalition (“Coalition”)¹ strongly supports your recent announcement that the Commission will undertake a comprehensive review of the proxy voting and shareholder communications system later this year. The Coalition is very appreciative of your leadership on this issue, given the many other significant matters currently before the Commission.

To help the Commission with its review of the proxy system, the Coalition has developed a Discussion Draft on Public Company Proxy Voting, with recommendations for modernizing and reforming the current framework. This Discussion Draft is an outgrowth of efforts by the members of the Coalition to improve the proxy system, which began formally with the establishment of the Coalition in 2005. The Coalition members also have been strong supporters of the Business Roundtable’s Petition for Rulemaking Concerning Shareholder Communications, filed with the Commission in April 2004.

Since its inception, the Coalition has been a consistent advocate for a comprehensive evaluation of the proxy system. You can examine the Coalition’s research and advocacy materials on its website at www.shareholdercoalition.com.

Attached is a copy of the Coalition’s Discussion Draft for your review and consideration. As a result of increasing shareholder activism and a multitude of regulatory proposals which will place additional burdens on the proxy process, the time has never been more right to implement changes that take better advantage of Internet communications, competitive market forces, and best practices.

¹ The Shareholder Communications Coalition (“Coalition”) comprises five associations: the Business Roundtable, the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries & Governance Professionals.

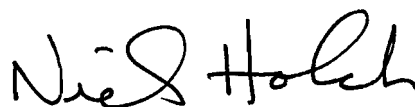
The Honorable Mary L. Schapiro
August 4, 2009
Page Two

The members of the Coalition look forward to discussing these recommendations with you, your fellow Commissioners, and with the SEC staff, as your agency examines this important area.

Please feel free to contact us with any questions you may have, or if you require additional information or clarification about any of the concepts presented in this Discussion Draft.

Thank you again for your leadership on these proxy “plumbing” issues.

Sincerely,

A handwritten signature in black ink that reads "Niels Holch". The signature is written in a cursive, slightly slanted style.

Niels Holch
Executive Director
Shareholder Communications Coalition

Attachment

cc: The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Kayla Gillan
Meredith Cross
Brian Breheny
James Brigagliano
Daniel Gallagher

Public Company Proxy Voting: Empowering Individual Investors and Encouraging Open Shareholder Communications

The U.S. proxy voting and communications system is in desperate need of modernization. In this position paper, the Shareholder Communications Coalition (“Coalition”)¹ describes the current system and its problems. The Coalition also offers recommendations for revising the current proxy rules to bring them into the 21st century and encouraging communications between shareholders and the companies in which they invest.

The U.S. Proxy Voting and Communications System

- The New York Stock Exchange (“NYSE”) estimates that 70-80% of all public company shares in the United States are held in “street” or nominee name, meaning that the underlying beneficial owners of the shares are not the shareholders of record. Under the street name system, legal title and ownership of individual shares reside with a depository institution, such as the Depository Trust Company (“DTC”).²
- State corporation law, which regulates most corporate governance matters, provides that only the shareholder of record has the right to vote on corporate matters, as the “legal” owner of the shares.
- When a public company seeks to hold a shareholder meeting, a record date is established to identify the current registered and beneficial owners who are eligible to vote at such shareholder meeting. The company notifies DTC, as the record holder for most of the corporate shares held in street name. DTC then provides a list of the brokers, banks, and other institutions holding a company’s shares in street name and issues an “omnibus proxy” to these institutions, granting them the authority to vote proxies at the upcoming meeting. Companies are then required to request information from these intermediaries regarding the number of proxy packets that need to be provided to them for distribution to beneficial owners.

¹ The Shareholder Communications Coalition currently comprises the following organizations: the Business Roundtable, the National Association of Corporate Directors, the National Investor Relations Institute, the Securities Transfer Association, and the Society of Corporate Secretaries & Governance Professionals. The Coalition’s website is located at www.shareholdercoalition.com.

² The street name system was established to improve the efficiency of securities trading by eliminating the need to transfer paper stock certificates. Under this system, stock certificates are immobilized and stored in a central depository created for this purpose. Stock transfers are then handled through an electronic book-entry process, which records transfers among financial intermediaries.

- Under Securities and Exchange Commission (“SEC”) and NYSE rules, brokers, banks and other financial intermediaries are responsible for handling proxy processing activities among their customers, including the delivery of proxy materials with information about the matters to be voted on at a shareholder meeting.

- Pursuant to these SEC and NYSE rules, public companies pay for the proxy processing services provided by these financial intermediaries. Reimbursement rates for the “reasonable expenses” of proxy services are established by the NYSE, subject to approval by the SEC. Companies have no choice in selecting a proxy service provider, exert little to no control over the services that are actually provided, and have no ability to negotiate fees with the service provider.

- The overwhelming majority of brokers and banks have contracted out their proxy processing responsibilities to a single service provider. Pursuant to written agreements, brokers and banks provide this service provider with contact information and share positions for their beneficial owners, along with a power of attorney to act as their agent in voting the shares for which they have been granted proxy authority. The service provider then distributes proxy materials through the mail or electronically to the beneficial owners of all company shares.

- As noted above, the service provider does not transmit actual “proxies” to beneficial owners; instead, it requests voting instructions from beneficial owners. Thus, in their proxy materials, beneficial owners do not receive proxy cards, but instead receive a voting instruction form (“VIF”) that is to be used by them to indicate their voting preferences. Beneficial owners then return this VIF for processing by the service provider. The use of a VIF form is necessary because brokers and banks retain the authority to cast the actual votes and do not transfer their proxy authority to the beneficial owner level.³

- If a beneficial owner has not provided specific voting instructions at least 10 days before a shareholder meeting, NYSE Rule 452 permits brokers to vote the shares of such owner if the proposal before the shareholder meeting is considered a “routine” matter. Under an amendment to Rule 452 recently approved by the SEC, an uncontested election of corporate directors would not be considered a “routine” matter, thereby prohibiting brokers from voting shares without receiving instructions from beneficial owners.

- Under rules adopted in the mid-1980’s, brokers and banks are required to classify beneficial owners as either Non-Objecting Beneficial Owners (“NOBOs”) or Objecting Beneficial Owners (“OBOs”), generally based on indications by beneficial

³ Since a broker or a bank retains the legal authority to vote at a shareholder meeting, a beneficial owner who attends such a meeting is not able to vote his or her shares using a VIF. Instead, the current rules require a beneficial owner to make special arrangements before the meeting to obtain a legal proxy to vote his or her shares. The use of a VIF at a shareholder meeting does not entitle a beneficial owner to vote in person at the meeting without a legal proxy.

owners at the time they open an individual account. Recent studies and surveys indicate a lack of uniformity among brokers regarding how beneficial owners are actually classified as NOBOs or OBOs. There are no standards or regulatory requirements for how a broker reviews this classification with its customers at account opening, or on a periodic basis to update this classification.

- The names of NOBOs may be disclosed to a public company by brokers and banks for a general communications purpose, although a list of NOBOs may not be used by a company for the distribution of its proxy materials. The names of OBOs may not be disclosed to a company for any purpose whatsoever.

- A further complication in the proxy system is the share lending programs of brokers and other intermediaries. Share lending enables a “short” investor to borrow shares from a “long” investor, with an agreement to return these borrowed shares at a later date. Share lending agreements generally assign voting rights to the borrower of the shares on a record date, causing the need for each intermediary to reconcile its long and short positions in order to accurately calculate the number of shares each investor is entitled to vote.

Problems with the Current Proxy System

- Research on the views and preferences of individual investors indicate a significant lack of knowledge about the proxy voting process and how it functions. This education gap is all the more critical due to current problems with the system, as detailed below.

- The NOBO/OBO classification system prevents public companies from knowing who many of their shareholders are and engaging in any meaningful communications with them. Research findings suggest that sometimes brokers use OBO as their default, meaning that some owners are classified as “OBOs” without their knowledge.

- At a time when changes in corporate governance are providing shareholders with more involvement and additional transparency, there is a critical need to ensure that public companies can communicate with their shareholders through a proxy system that is accurate and flawless. Under the current system, companies seeking to encourage more voting participation by beneficial owners cannot do so without using a circuitous and expensive process that is controlled primarily by one service provider acting as an agent for brokers and banks, yet funded by the public companies themselves. The continued reliance on this single provider for proxy administrative services has resulted in a system in which fees are established by regulatory fiat rather than by a free market that would take shareholder interests into account.

- The use of share lending schemes and certain derivative strategies by hedge funds and other institutional investors have permitted a decoupling of voting rights from the economic ownership of corporate shares. This decoupling of rights offers the

potential for, and there have been actual cases of, these investors manipulating the proxy voting process for the purpose of gaining a strategic market advantage.

- Furthermore, the increased use of share lending by brokers can cause a broker to cast more votes than it is entitled to cast in a corporate election. More than a majority of brokers hold their shares in fungible bulk, and do not reconcile their long and short positions to determine which investors are eligible to vote before a proxy mailing is sent. This lack of pre-mailing reconciliation by brokers when a record date is established makes it impossible for a vote tabulation to be completely accurate, a goal that is especially important in a close vote on a director election or a shareholder proposal.

- Reports in the news media of voting miscounts and delays in determining election results by proxy service providers have raised questions about the integrity of the proxy voting process. Additionally, there does not appear to be any ability for an independent third-party to audit and verify the results of a close election. These problems need to be addressed, as increasing investor activism and proposed regulatory changes are expected to cause many more close votes on shareholder proposals and director elections.

Proxy Practices in Other Countries

Unlike the U.S., other countries have avoided the creation of artificial barriers between public companies and their shareholders, choosing instead to have beneficial ownership transparency and permitting companies to have direct communications with their investors.

- In the United Kingdom, a public company has the right to learn the identity of individuals and institutions with voting rights and/or beneficial owner interests in its shares.⁴ This information is acquired through a written notice process that permits a public company the power to investigate the ownership of its shares. The law imposes both civil and criminal penalties for a failure to provide the requested information within a required time period.⁵

- In Australia, a public company is required to keep a register with the name and address of all its shareholders, including beneficial owners.⁶ The disclosure of identity and address information on matters unrelated to the interests or rights of shareholders in the affairs of the company is not allowed.⁷

- In Canada, a public company is permitted to have direct communications with its beneficial owners.⁸ However, Canada has maintained the NOBO/OBO classification and it is still expensive for public companies to communicate with all their

⁴ Section 793 of the Companies Act 2006.

⁵ Sections 794 and 795 of the Companies Act 2006.

⁶ Section 169 of the Corporations Act 2001. In the Corporations Act, shareholders are referred to as "members."

⁷ Section 177 of the Corporations Act 2001.

shareholders in Canada because of the complex chain of intermediaries involved in the proxy process.

The Shareholder Communications Coalition **Proxy Process Reform Plan**

In light of the overwhelming problems with the current proxy voting and communications system, the Shareholder Communications Coalition offers the following recommendations as a starting point for discussions about reforming the system:

1. **Investor Education**. As a new proxy voting and communications system is implemented, a national investor education campaign should be launched to explain the proxy voting process and to encourage individual investors to vote their proxies at shareholder meetings. Survey research indicates that the substantial majority of individual investors do not understand the workings of the proxy system.
2. **NOBO and OBO Classification**. Public companies should have access to contact information for all of their beneficial owners and should be permitted to communicate with them directly. The NOBO and OBO classification for beneficial owners should be eliminated.

Those beneficial owners wishing to remain anonymous should be permitted to register their shares in a nominee account with their broker, bank, or other third-party intermediary. Beneficial owners should not bear the cost of this registration, either directly or indirectly. Those who are currently classified as OBOs should have adequate notice of the elimination of their OBO status, to permit them to decide whether to establish a nominee account.

Communications with beneficial owners should only be for purposes involving the corporate or business affairs of a company. Federal privacy regulations should apply to the use of beneficial owner information received from a broker or bank.⁹

3. **Competition among Proxy Service Providers**. The current functions of (a) beneficial owner data aggregation, and (b) proxy communications distribution should be separated, providing a public company with the opportunity to select a proxy distribution provider of its own choosing. The proxy distributor should be responsible for transmitting the proxy statement and proxy forms to all shareholders, once the beneficial owner list is obtained from an entity serving as the data aggregator. The prices for proxy distribution and

⁸ National Instrument 54-101.

⁹ SEC regulations permit the disclosure of information: (a) “necessary to effect, administer, or enforce a transaction that a consumer requests or authorizes”; or (b) “as permitted by law.” See 17 C.F.R. § 248.14(a), 17 C.F.R. § 248.14(b)(2), and 17 C.F.R. § 248.15(a)(7)(i). Similar privacy provisions apply to banks.

communications services should be established by open competition among service providers handling these functions, based on value to end users, and not through a fee schedule established by regulators.

4. **Beneficial Owner List Compilation.** The lists of beneficial owners used for shareholder meetings and other communications purposes should be maintained by a data aggregator selected by a special committee of the NYSE established for this purpose. The compilation of the beneficial owner lists for shareholder meetings should become a non-profit function, and a fee schedule should be established for access to the beneficial owner lists by the NYSE.

The data aggregator would obtain beneficial owner contact information from all brokers, banks, and other intermediaries, but no information about any intermediary relationship with a customer would be provided. In other words, as is the case today, the names of brokers and other intermediaries with whom the beneficial owners maintained their accounts would not be disclosed.

Beneficial owner positions should be fully reconciled as of a specified record date for a shareholder meeting. This share position reconciliation should include shares on loan and any “failure to deliver” shares. All intermediaries would be required to reconcile beneficial owner and other positions back to their total holding position at DTC or another depository institution.

Access to beneficial owner lists should be non-discriminatory. Both a company and its shareholders seeking to communicate with beneficial owners should have equal access to the beneficial owner list, upon payment of the NYSE-approved fee for this list.¹⁰ As noted above, beneficial owner lists should only be used for communications involving the corporate or business affairs of a company.

The special NYSE committee should use a competitive bidding process to select and retain the data aggregator. The committee should enter into a contractual agreement with the data aggregator for a recommended term of five (5) years.

The special NYSE committee should also be responsible for the ongoing oversight of the data aggregator selected for this purpose. The committee should comprise representatives of brokers, banks, issuers, institutional investors, individual investors, and other identified stakeholders.

5. **Proxy Vote Counting and Tabulation.** Proxy votes should continue to be counted and tabulated using the current practices governed by state law, including, when necessary, the services of an independent inspector of elections.

¹⁰ Access to the beneficial owners list will be provided at the same reimbursement fee to company shareholders wishing to communicate with other shareholders.

6. **Beneficial Owner Proxy Authority.** Proxy voting authority should be transferred to each beneficial owner, as of the record date established for a shareholder meeting, through the same omnibus proxy process that is currently employed by DTC. Beneficial owners would be free to transfer their proxy authority back to their broker or bank—through a client-directed voting agreement or similar arrangement—or to another third-party intermediary. A transfer of proxy authority to the beneficial owner level eliminates the need for broker discretionary voting under NYSE Rule 452 and also eliminates the need for brokers and banks to provide their service provider with a power of attorney for proxy voting purposes.¹¹

7. **Integrity of Proxy Voting Process.** The proxy voting process should be fully transparent and verifiable, starting with the compilation of a reconciled list of beneficial owners eligible to vote and ending with the final tabulation of votes cast at a shareholder meeting.

Brokers and other financial intermediaries engaged in share lending (or with “failure to deliver” positions) should be required to reconcile their share positions as of the record date for each shareholder meeting. This reconciliation should occur before an intermediary transmits record date beneficial owner information to the data aggregator discussed above and before proxy forms are mailed to beneficial owners and registered shareholders. All record date positions maintained by financial intermediaries should be reconciled early in the voting process, to avoid distributing proxies to ineligible shareholders and to avoid discrepancies in tabulating final vote counts.¹²

The vote counts on matters before a shareholder meeting should be auditable and capable of third-party verification, so that a validation of the final tabulation of the votes of both registered and beneficial owners can occur.

¹¹ If this recommendation is adopted, there would no longer be any broker discretionary voting pursuant to NYSE Rule 452, which currently permits brokers to vote uninstructed shares on routine matters at a shareholder meeting. The SEC recently approved an amendment to Rule 452 that would no longer permit brokers to exercise this discretionary authority in uncontested director elections.

¹² This proposed process would be facilitated by a recent amendment to the Delaware General Corporation Law permitting a board of directors to fix one record date for shareholders entitled to notice of a meeting and a separate record date for determining the shareholders entitled to vote at such a meeting. This new amendment should help a company better align the economic and voting interests of its shareholders and reduce the risk of having investors with voting rights but no share ownership as of the date of the shareholder meeting.