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- ▶ Existing proxy system prevents direct communication with shareholders
- ▶ Beneficial owner classification system needs to be abolished
- ▶ Greater competition among proxy service providers is required
- ▶ Independent data aggregator should establish beneficial owner lists

By Niels Holch

A road map to reform

It is critical to reform the proxy system, which is antiquated and overly expensive. Public companies should know who their beneficial owners are and should be able to communicate directly with them on corporate matters, and the proxy voting process needs to be reformed to ensure an accurate and auditable shareholder vote.

Issuers seeking to encourage more voting participation by beneficial owners cannot do so without using a process that some feel is overly complicated and inefficient. This system classifies investors into objecting beneficial owners (OBOs) and non-objecting beneficial owners (NOBOs), and discourages direct communications on proxy matters. Issuers exercise little to no control over the proxy services provided to them, yet they have to pay for them. Share lending activities by financial intermediaries can also mean more votes cast than should be in a shareholder vote.

The Street name system has provided a very efficient securities trading framework for capital market participants, but as many intermediaries hold their shares in fungible bulk, this can cause problems when a shareholder meeting needs to occur. Many brokerage firms do not reconcile their long and short positions before a proxy mailing is sent, making it impossible for a vote tabulation to be completely accurate.

A potential fix

These problems need to be addressed, especially with increasing investor activism and looming regulatory changes that are expected to result in many more close votes on shareholder proposals and director elections.

In response, the Shareholder Communications Coalition has developed the following recommendations for the SEC to consider.

▶ **Investor education:** As a new proxy voting and communications system is implemented, a national investor education campaign should be launched to explain the process and encourage individual investors to vote their proxies. Survey research indicates that most individual investors do not understand the workings of the proxy system. Individual issuers should also consider dedicating a portion of the investor relations section of their website to help educate individual investors about the proxy process.

▶ **NOBOs and OBOs:** Public companies should have access to contact information for all their beneficial owners and should be permitted to communicate with them directly. The NOBO/OBO classification

for beneficial owners should be eliminated. Beneficial owners wishing to remain anonymous should be permitted to register their shares in a nominee account with their broker, bank or other intermediary. Beneficial owners should not bear the cost of this registration. Those classified as OBOs should have adequate notice of the elimination of their OBO status, so they can decide whether to establish a nominee account.

▶ **Competition among proxy service providers:** The functions of beneficial owner data aggregation and proxy communications distribution should be separated, providing a public company with the opportunity to choose a proxy distribution provider. The proxy distributor should be responsible for transmitting the proxy statement and forms to all



THE PICTURE OVERSEAS

Unlike the US, other countries have avoided the creation of artificial barriers between public companies and their shareholders, choosing instead to have beneficial ownership transparency and direct investor communications. In the UK, 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. This information is acquired through a written notice process that gives a public company the power to investigate ownership of its shares.

In Australia, a public company must keep a register with the names and addresses of all its shareholders; this is similar to the system used in some Nordic countries. In Canada, a public company is permitted to have direct communications with its beneficial owners, though this is expensive because of the number of intermediaries involved in the proxy process.

shareholders, once the beneficial owner list is obtained from the data aggregator. The prices for proxy distribution and communications services should be established by open competition among service providers, not through a fee schedule established by regulators.

► **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. List compilation should become a non-profit function, and a fee schedule should be established for access to the 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. In other words, the names of brokers and other intermediaries with which the beneficial owners maintained their accounts would remain undisclosed.

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 the Depository Trust Company (DTC) or another depository institution. Access to beneficial owner lists should be available to both a company and its shareholders.

The special NYSE committee should use a competitive bidding process to select and retain the data aggregator,

entering into a contractual agreement with the aggregator for a recommended term of five years. The NYSE should also be responsible for the ongoing oversight of the data aggregator.

► **Vote counting and tabulation:** Proxy votes should continue to be counted and tabulated using the practices governed by state law, including, when necessary, the services of an independent inspector of elections.

► **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 process currently employed by the DTC. Beneficial owners would be free to transfer their proxy authority back to their broker or bank, through a client-directed voting agreement.

► **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 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 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 discrepancies in tabulating final vote counts.

If adopted, these recommendations would bring the proxy voting and communications system into the 21st century, permitting issuers to have direct and open communications with their beneficial owners and ensuring the shareholder voting process produces an accurate and verifiable vote count. ■

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