

NYSE Informed Investor

Margin Customers: Know Your Shareholder Rights on Proxies and Dividends

Customers who buy shares on margin or who otherwise borrow money from their brokerage firm should be aware that, under certain circumstances, they may lose their right to vote some of the shares in their account.

When a customer with a margin account¹ borrows money from his or her brokerage firm, whether as the result of a purchase of securities on margin or through a loan for other purposes, member organizations have the right to hypothecate. This means they can pledge the shares as collateral for a loan at a bank. Also, the brokerage firm can lend the shares to other customers or to other broker-dealers, according to margin agreements with their customers and subject to certain regulatory limitations.

The brokerage firm—not the customer—usually reserves the right to choose which securities will be pledged in the margin account. When shares are lent, the right to vote the shares goes with them. That means if a corporate vote takes place while the shares are on loan, the margin customer may be unable to vote those shares.

In many corporate elections, the issue has been rendered moot by the fact that only a fraction of a brokerage firm's customers choose to vote their shares. With large quantities of customer shares as to which no voting instructions have been given, brokerage firms have been able to follow the instructions of customers without worrying about whether or not a particular customer's shares are out on loan. However, under certain conditions, such as closely fought proxy contests or contested elections, where a greater number of customers than usual actually choose to vote, there may not be sufficient margin account shares that are not on loan to permit the firm to vote all the margin shares for which it receives instructions. In such a situation, a margin account customer may not be able to vote their shares.

If you use margin credit, you should check with your broker to see what your brokerage firm's policy is in this matter. You should review your customer agreement and margin agreement that you received from your brokerage firm, and speak with your broker to seek an explanation of your rights regarding proxy voting for shares held in a margin account. Naturally, if the right to vote in a given situation is felt to be critical, repaying the outstanding margin balance may resolve the problem.



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A similar issue is raised with regard to dividends when a customer's securities in a margin account are lent. In this case, a margin customer is at risk of receiving payments-in-lieu of dividends when shares are lent past the ex-dividend date. When shares are lent out to facilitate margin lending, the person borrowing the shares receives the dividend, and the margin customer receives a cash payment from his or her brokerage firm in an amount identical to the dividend. However, the cash payment is not a dividend for tax purposes. When a customer receives the cash payment, the broker must reflect it as ordinary income on the year-end tax statement. It is not eligible for preferential tax treatment. Many member organizations make extraordinary efforts to avoid having customers receive payments in lieu of dividends, and some go so far as to "gross up" such payments to reflect the loss of preferential tax treatment when payments in lieu are unavoidable. Check with your broker to see what your brokerage firm's policy is on this issue.

¹Customers with cash accounts, such as an IRA, and customers with margin accounts who do not borrow from the member organization (i.e., securities are fully paid for by the customer), are not affected by this issue.