

SHAREHOLDER COMMUNICATIONS COALITION RELEASES RECOMMENDATIONS TO REFORM THE PROXY SYSTEM

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On August 4, 2009, the Shareholder Communications Coalition (“Coalition”) released a concept paper with its recommendations for how to modernize the U.S. proxy system. This concept paper will be considered by the Securities and Exchange Commission (“SEC”), as it begins to evaluate its proxy infrastructure rules.

The Securities Transfer Association is a founding member of the Coalition and your leadership provided significant input into the development of these Coalition recommendations.

Every transfer agent knows how critical it is to reform the proxy system—a system that 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.

The Problems with the Current Proxy System

Issuers seeking to encourage more voting participation by beneficial owners cannot do so today without using a circuitous process that is controlled primarily by one service provider. This system classifies investors into “objecting” and “non-objecting” categories and discourages direct communications on proxy matters. Issuers exercise little to no control over the proxy services that are being provided to them, yet they fund these services. Additionally, share lending activities by financial intermediaries can cause intermediaries to cast more votes than they are entitled to cast in a shareholder vote.

The street name system has provided a very efficient securities trading framework for capital market participants. However, the fact that many intermediaries hold their shares in fungible bulk can cause problems when a shareholder meeting needs to occur. Many brokerage firms 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. It also prevents the ability of an independent third-party to audit and verify the results of a close election.

These problems in the proxy voting and shareholder communications system 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.

Proxy Practices in Other Developed 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 direct investor communications.

- 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. This information is acquired through a written notice process that permits a public company the power to investigate the ownership of its shares.

- In Australia, a public company is required to keep a register with the name and address of all its shareholders. A similar system of direct registration of shareholders is also used in certain Nordic countries.

- In Canada, a public company is permitted to have direct communications with its beneficial owners. However, it is still expensive for Canadian public companies to communicate with all their shareholders because of the number of intermediaries involved in the proxy process.

The Shareholder Communications Coalition Recommendations

To respond to the overwhelming problems with the current proxy voting and communications system in the United States, the Shareholder Communications Coalition developed the following recommendations for the SEC, 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.

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¹ The Shareholder Communications Coalition (“Coalition”) comprises five associations: Business Roundtable, National Association of Corporate Directors, National Investor Relations Institute, The Securities Transfer Association, and Society of Corporate Secretaries & Governance Professionals. More information about the Coalition can be accessed through its website at www.shareholdercoalition.com.

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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.

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 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 New York Stock Exchange ("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 the Depository Trust Company ("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.

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. This special committee should also be responsible for the ongoing oversight of the data aggregator selected for this purpose and 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.

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.

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

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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.

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.

Conclusion

If adopted, these recommendations by the Shareholder Communications Coalition 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 that the shareholder voting process produces an accurate and verifiable vote count. With the prospect of many more close votes on shareholder proposals and director elections on the horizon, it is in the interests of all market participants to support reforms such as these to improve the proxy system. ■

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