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Who Pays for Proxy Reform?

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Securities Industry Blog, January 12, 2010

Proxy reform. It's on the Securities and Exchange Commission's list of initiatives this year but just what it should spell will likely continue to be one of the most heated topics to cross the regulator's desk.

In one corner is the New York-based Broadridge Financial, which is only too eager to tout the efficiencies of the current system in which it holds a virtual monopoly. It's actually the world's largest distributor of proxy materials for broker dealers and banks on behalf of beneficial shareholders. On the other corner are the Washington, D.C.-based Shareholder Communications Coalition (SCC) representing issuers and transfer agents, and The Altman Group, a proxy solicitation firm in New York. They say plumbing in the proxy industry is in major need of overhauling.

Who is right? The Securities and Exchange Commission deserves a lot more information on just who is paying for what services – and how much the payment might come to if the process were changed before it can make a decision. And it needs to know just who would benefit from any change and why. Would it be issuers, financial intermediaries or investors?

The SCC and Altman Group say that issuers should have equal access to their registered and beneficial shareholders so they can present their case – and understand where the opposition stands. And while they have been griping about the status quo for the past few years, they have a better chance at being heard now that the SEC's Chairman Mary Shapiro has expressed concerns over the decline in the participation of retail investors in corporate agenda. A review of the proxy communications process is underway. And a concept release could be issued shortly.

While the SEC's notice and access rule, adopted in 2007, was intended to reduce the costs for issuers to communicate with shareholders electronically but it has resulted in lower retail participation in corporate agendas. So will the New York Stock Exchange's new elimination of Rule 452 which allowed broker-dealers to vote on behalf of beneficial shareholders in routine corporate meetings if the investors didn't do so on their own.

Although corporations can request from banks and brokerages the names of investors who do not object to being solicited – otherwise known as non-objecting beneficial owners or NOBOs, they aren't allowed to mail proxy materials to them. And there are plenty of beneficial shareholders who hold their shares in the names of their financial intermediaries. An estimated 80 percent of

all U.S. investors hold their accounts in the name of their bank or brokerage firm and of those about two-thirds are NOBOs. The remainder are OBOs- objecting beneficial owners who don't want their identities disclosed.

Giving corporations direct access to their beneficial shareholders goes hand in hand with giving them a say in who will mail or electronically distribute their proxy materials and counts up their votes, according to Niels Holch, a spokesman for the SCC, whose Washington, D. C. law firm of Holch & Erickson was hired by the SCC in mid- 2008 to promote its agenda on Capitol Hill.

If issuers had a say, the SCC believes, Broadridge wouldn't have a virtual monopoly in the proxy mailing and e-distribution industry because corporations could pick whoever they wanted. Because brokers and banks alone decide who they want to do their proxy work – and they have picked Broadridge -- issuers are forced to use Broadridge whether they want to or not. Or so the SCC claims.

There is no regulation prohibiting broker dealers and banks from choosing another firm but so far nobody has emerged to successfully compete against Broadridge which spends plenty to ensure its stronghold. During 2009 alone, Broadridge invested over \$100 million in systems and processes and its technology is helping issuers adapt to the SEC's notice and access rule, says Chuck Callan, senior vice president of regulatory affairs at Broadridge.

Holch and The Altman Group also don't appear to have any complaints about Broadridge's efficiencies. And neither do broker-dealers and banks which no longer have the burden of maintaining sizeable proxy departments. Broadridge collects the proxy fees from issuers on behalf of the brokers and banks it services and divides those fees between itself and the financial intermediaries. No one except for Broadridge and the financial intermediaries-- is privy to the split. Most of the fees are set by the New York Stock Exchange.

So what's the alternative? The SCC proposes splitting the process of obtaining the names of beneficial shareholders from the proxy distribution work. A committee selected by the NYSE would pick the data aggregator to collect the names of the beneficial shareholders to give corporations. The NYSE would set the fee schedule for such a service and the data aggregator would work on a not-for-profit basis akin to the Depository Trust & Clearing Corp. But issuers would be free to choose whoever they wanted to mail their proxy materials and pay mutually agreed upon fees, and not fees set by the NYSE.

The SCC's proposal wouldn't eliminate Broadridge completely from the picture as it could compete for the data aggregation and proxy mailing business. Presumably DTCC, if interested, could also compete for the business of finding out the names of the beneficial holders. So could Broadridge, any competing vendors and transfer agents, who currently help issuers with proxy distributions to registered shareholders.

The Altman Group's plan is similar proposal to the SCC's with one key difference. Under the Altman Group's plan called ABO – short for all beneficial owners – issuers would only ask for the names of OBOs during a limited number of times a year. The SCC says it doesn't want to impose that type of restriction but its plan allows OBOs to hide behind nominee name- the name of their financial intermediaries

Should OBOs be required to give up their identities? The broker-dealers and banks might not think so.

But there is still one key unanswered question. Would either the SCC's plan or Altman's plan be more cost-effective for issuers? Holch concedes that the SCC hasn't done a comparative analysis of whether issuers would be paying more – or less- than they currently do using Broadridge's services through their banks and brokerages.

Cost isn't everything, according to Holch and Altman. It's the principle of the matter. But the SCC, says Holch, believes that more frequent electronic communications between issuers and their beneficial shareholders will eventually lower issuers' costs. For issuers interacting by mail, even if the costs were higher than they are currently, issuers may be willing to pay more just to ensure they get their message across to all of their investors directly. That means both registered and beneficial shareholders

But Broadridge suggests its critics should put their money where their mouth is. "The heavy lifting [in the proxy industry] is in the technology innovation, in the networking, in the data aggregation, in the specialized processing, in the electronic voting platforms, and in the ability to bring together the bricks 'n clicks on an efficient, timely, and compliant basis consistent with investors' preferences," says Callan.

So far, no not-for-profit organization has stepped forward to write the check – aka spend the money needed to participate in the proxy arena. Broadridge is even making a dent in the distribution business for registered shareholders – a business once reserved for transfer agents. During the past year, 1,200 of the largest companies also selected Broadridge to provide services to their registered shareholders, says Callan.

Broadridge's argument has some merit. The SEC needs to ask the SCC and other critics of the status quo to come up with a dollars and cents analysis of how their proposals stack up against the status quo. Ideally, firms such as DTCC, transfer agents and even competitors of Broadridge will explain just how they plan to follow in Broadridge's footsteps and at what cost to issuers.

But Broadridge also needs to cough up its cost-benefit analysis of the status quo – and include in its analysis just how it splits the fees paid by issuers with the

financial intermediaries which hire Broadridge. Broker dealers and banks should also explain whether – and just how much – they financially benefit from the current system. Outsourcing their proxy distribution business to Broadridge has allowed them to downsize their proxy departments but is what they earn – through the splitting of fees with Broadridge – allowing them to enjoy a hefty profit margin at the expense of issuers? Nobody knows the answer for certain.

Regulators now want Wall Street firms to open the kimono about their trading activities and decision-making process so they can understand systemic risk. Its only fair that the SEC require complete transparency in the proxy industry. Anything less will only continue to fuel criticism of Broadridge and the current process without any clear understanding of how – and whether – changes should be made.