

**September, 2006**

## **Suggested Practice Guidelines for Proxy Processing**

### Introduction:

The Securities Industry Association, in conjunction with its Corporate Actions, Securities Operations and Securities Lending Divisions has compiled the following list of Suggested Practice Guidelines for Proxy Processing. These suggested practices have been developed in recognition that outside proxy service providers are often employed by member firms in order to achieve processing efficiencies and economies of scale. Because the industry significantly utilizes the services of ADP Investor Communications for this purpose, we have reviewed their processes and have made specific reference to their program throughout this paper.<sup>1</sup> The practices described herein may be applicable to other outside proxy service providers that a broker-dealer may use.

Concerns have been raised about “over reporting” of proxies<sup>2</sup> by Depository Trust Company (“DTC”) participants.<sup>3</sup> “Over reporting” has been defined as the submission of votes, either directly or through a third party proxy service provider, in excess of the votable position for that participant. In those instances where over reporting has been detected by regulators, it has been determined that the over reporting organization had failed to reconcile its votable shares with the instructions that were submitted to its proxy service provider. A common reason for over reporting is the failure to properly aggregate all of the participant’s record date holdings. The votable position may include:

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<sup>1</sup> By contracting with ADP combined with having the proper internal monitoring procedures in place, broker-dealers can access ADP’s Proxy Plus system that can be used to meet their regulatory responsibility to monitor ADP’s processing of their proxies. The ADP system includes many tools for accurate proxy processing throughout the life cycle including real-time positions and reports. ADP is required by their contract with each financial institution, to maintain the applicable records up to and in some cases exceeding seven years in accordance with regulatory rules.

<sup>2</sup> Reference NYSE Member Firm Regulation Information Memo 04-58 dated November 5, 2004, regarding the supervision of proxy activities and over-voting.

<sup>3</sup> DTC, a subsidiary of The Depository Trust & Clearing Corporation, offers custody and book-entry settlement services for its participants. All securities on deposit at DTC are registered in its nominee name, “Cede & Co.,” and Cede & Co. is therefore the shareholder of record. Cede & Co. must assign its voting rights to participants at the time of any proxy solicitation, and does so through an “omnibus proxy” process under which, among other matters, the issuer is advised of the exact share holdings in each DTC participant account.

1) shares held in multiple DTC participant accounts;<sup>4</sup> 2) shares registered in the participant's name or its nominee's name or 3) shares held at another custodian(s)/Central Securities Depository (CSD).

Suggested Proxy Practices:

1. It is the responsibility of the broker-dealer to have proper controls in place to monitor the entire proxy process, whether or not an outside service provider is utilized for proxy processing. Based on the record date, the issuer will receive information from DTC showing the positions of participants for that date (through the "omnibus proxy" process). This allows the issuer to know the amount of shares the DTC participant holds.<sup>5</sup>
2. For record date positions provided by DTC:
  - Adjust the outside proxy service provider's totals by decreasing or increasing where discrepancies may occur, especially if participants use more than one DTC participant account.
  - Adjust the outside proxy service provider's totals to include shares registered in the broker-dealer/bank's name, or held at other custodians, when applicable.
3. Participants are given the voting entitlement pursuant to the omnibus proxy and security position listing issued by DTC. This document transfers the voting authority from DTCC's nominee Cede & Co. to the participant. A valid proxy must be issued and signed in the name of the participant having the authority to vote. Although the participant has the legal authority to vote, it must follow the voting instructions given by its customers. In the event all of a broker-dealer's clients do not provide voting instructions, broker-dealers may submit a discretionary vote as permitted by the New York Stock Exchange (NYSE) rules<sup>6</sup> which agrees to their votable record date position.

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<sup>4</sup> ADP identifies to the tabulator those broker-dealers who have indicated they have multiple DTC participant accounts by including those firms on an association table issued with each vote. ADP offers an Over Reporting Prevention Service that works in conjunction with broker-dealers to avoid over reporting. Every ADP Proxy subscriber should utilize this service.

<sup>5</sup> To prevent an over reporting situation when utilizing ADP, firms should utilize ADP's Over Reporting Prevention Service in conjunction with an internal reconciliation process. DTC participants utilizing ADP must authorize DTC to pass their record date positions to ADP so that the maximum allowed voting totals for their combined DTC participant account positions may be monitored by ADP's Over Reporting Prevention Service.

<sup>6</sup> Under the current NYSE and SEC proxy rules, brokers must deliver proxy materials to beneficial owners and request voting instructions in return. If voting instructions have not been received by the tenth day preceding the meeting date, brokers may vote on certain matters deemed "routine" by the NYSE. One of the most important results of broker votes of uninstructed shares is their use in establishing a quorum at shareholder meetings.

4. Broker-dealers should not report security positions to an outside proxy service provider for shares held in registered certificate form for clients in safekeeping in their (client's) name or in the client's Direct Registration System (DRS) position. This will eliminate issuance of duplicate proxy voting cards/forms.
5. On or soon after record date, the broker-dealer should do a reconciliation of long customers (beneficial owners) to street-side holdings. Internal reconciliation permits a firm to anticipate over reporting situations.<sup>7</sup> For purposes of voting, street-side holdings include shares held at DTC, other depositories,<sup>8</sup> and/or registered in the participant's name. The combined holdings must be accurately reflected on the outside proxy service provider's system (for ADP it's the Proxy-Plus system).
6. The broker-dealer has the responsibility to review the reconciliation reports provided by the outside proxy service provider. Adjustments may have to be made to the votable position, for example, due to a stock loan or a fail to receive. If there are a greater number of votes received than the total firm's votable position, the broker-dealer should make the necessary adjustment prior to the results being sent to the tabulator.<sup>9</sup> Based upon the reconciliation methodology used by the firm, each participant must decide how to adjust the amount of shares the beneficial owners are entitled to vote. If more than one account needs to be adjusted, the vote should be adjusted fairly and equitably by utilizing such methodology as an impartial lottery or proration.
7. Broker-dealers should review their loan agreement to ensure there is proper disclosure regarding proxy voting. It is important for margin account customers to understand that the number of shares eligible to vote may be adjusted downward.
8. After the vote has been submitted by the outside proxy service provider, transfer agents acting as tabulators, as well as independent inspectors of election, may alert the outside proxy service provider and/or the broker-dealer/bank community of over-reporting. If a tabulator contacts a participant to reconcile a position, it is

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<sup>7</sup> Participants must decide if they are going to reconcile their customer's votable positions before or after (Pre or Post) the ballot mailing. Both methods are suitable as long as there is correct supervision, and impartial allocation methods that are fair and equitable among all clients in the event that the amount of shares the holder is entitled to vote needs to be adjusted.

<sup>8</sup> Broker-dealers should remain cognizant of the fact that positions at a foreign depository such as Clearstream may be directly registered on the books of the issuer's transfer agent and, therefore, not be part of the DTC totals. These foreign positions may have to be voted through other means.

<sup>9</sup> ADP, on behalf of the participants can then provide the tabulators with a vote that reconciles to the votable record date position.

imperative that the participant resolves the discrepancy before the meeting date. Consideration should be given to solutions to avoid recurrence of the problem.

9. Record Retention: The record retention procedures for the broker-dealers should reflect the work performed by its proxy department in today's environment (i.e. client proxy support; monitoring of outside service provider's proxy function; and the international proxies). In addition, broker-dealers are to maintain records in an accessible location.<sup>10</sup>
10. Record Retrieval: Broker-dealers should have the necessary procedures in place to retrieve records requested by a regulator within 3 business days for records 1 year old or less and 5 business days for records over 1 year old.

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<sup>10</sup> SIA understands that in accordance with NYSE rules, the housing of a broker-dealer's proxy processing and voting records at ADP adheres to the requirements of accessibility.