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# Executive Summary

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## SEC's Concept Release on the U.S. Proxy System

### INTRODUCTION:

On July 14, 2010, the SEC approved and released a “concept release” seeking comments on potential changes to the U.S. proxy system.<sup>1</sup> As the Commission explained: the SEC is “publishing this concept release to solicit comment on various aspects of the U.S. proxy system. It has been many years since we conducted a broad review of the system, and we are aware of industry and investor interest in the Commission’s consideration of an update to its rules to promote greater efficiency and transparency in the system and enhance the accuracy and integrity of the shareholder vote. Therefore, we seek comment on the proxy system in general, including the various issues raised in this release involving the U.S. proxy system and certain related matters.”

### WHY IS THE SEC CONSIDERING MAJOR CHANGES TO THE PROXY SYSTEM?

The SEC explained in the release: “commentators (have) raised concerns about the proxy system as a whole. In addition, the Commission’s staff often receives complaints from individual investors about the administration of the proxy system. We believe that these concerns and complaints merit attention because they address a subject of considerable importance—the corporate proxy--which, given the wide dispersion of shareholders, is the principal means by which shareholders can exercise their voting rights. Accordingly, in this release, we are reviewing and seeking public comment as to whether the U.S. proxy system as a whole operates with the accuracy, reliability, transparency, accountability, and integrity that shareholders and issuers should rightfully expect...Moreover, recent developments, such as the revisions to Rule 452 of the New York Stock Exchange (‘NYSE’) limiting the ability of brokers to vote uninstructed shares in uncontested director elections and other corporate governance trends such as increased adoption of a majority voting standard for the election of directors have highlighted the importance of accuracy and accountability in the voting process.”

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<sup>1</sup> The SEC’s announcement is available at <http://www.sec.gov/news/press/2010/2010-122.htm>  
The text of the release is available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>

The text of the release covers 151 pages, but a large portion of that is spent providing background information on key issues (much of which will already be familiar to readers). The Commission also provides a framework for analyzing each issue raised by outlining “some of the concerns that have been raised regarding the accuracy, reliability, transparency, accountability, and integrity of this system.” Finally, the Commission asks for comments on various concerns and introduces “possible regulatory responses to these concerns.” It should be noted that the Commission is still at the stage where it is asking (quoting from the release): “Whether we should take steps to enhance the accuracy, transparency, and efficiency of the voting process; whether our rules should be revised to improve shareholder communications and encourage greater shareholder participation; and whether voting power is aligned with economic interest and...disclosure requirements provide investors with sufficient information about this issue.”

The focus of this executive summary will be to detail the “potential regulatory responses” raised by the Commission in its concept release. The Commission’s specific “requests for comment” (and related questions) revolve around the concepts presented in the release as potential regulatory responses. Those seeking detailed background information or lists of questions (“requests for comment”) on specific issues and concepts are urged to review the relevant sections of the concept release, which covers the following topics:

- ✓ The Current Proxy Distribution and Voting Process (Overview);
- ✓ Types of Share Ownership and Voting Rights (Registered vs. Beneficial Owners);
- ✓ The Process of Soliciting Proxies (Distributing Proxy Materials to Registered vs. Beneficial Owners);
- ✓ Role of the Depository Trust Company (DTC);
- ✓ Role of Broker-Dealers and Banks;
- ✓ Role of Third Parties in the Proxy Process (Transfer Agents, Proxy Service Providers, Proxy Solicitors, Vote Tabulators, and Proxy Advisory Firms);
- ✓ Over-Voting and Under-Voting (Imbalances in Broker Votes, Securities Lending, Fails to Deliver);
- ✓ Current Reconciliation and Allocation Methodologies Used by Broker-Dealers to Address Imbalances (Pre-Reconciliation, Post-Reconciliation, and Hybrid Reconciliation Methods);
- ✓ Vote Confirmation;
- ✓ Proxy Voting by Institutional Securities Lenders;
- ✓ Disclosure of Voting by Funds;
- ✓ Proxy Distribution Fees (Current Fee Schedules, Notice and Access Model);
- ✓ Communications and Shareholder Participation (Overview);
- ✓ Issuer Communications with Shareholders (Overview);
- ✓ Means to Facilitate Retail Investor Participation (Enhanced Brokers’ Internet Platforms, Advance Voting Instructions [Client Directed Voting], Investor-to-Investor Communications, Improving the Use of the Internet for Distribution of Proxy Materials [Notice and Access]);
- ✓ Data-Tagging of Proxy-Related Materials;
- ✓ The Relationship between Voting Power and Economic Interest (Overview);
- ✓ Proxy Advisory Firms (Concerns About the Role of Proxy Advisory Firms, Conflicts of Interest, Lack of Accuracy and Transparency in Formulating Voting Recommendations);
- ✓ Dual Record Dates;
- ✓ “Empty Voting” and Related “Decoupling” Issues.

**POTENTIAL REGULATORY RESPONSES:**

The text of the release focuses on a set of reform concepts. The following is a compilation of concepts identified in the release as “potential regulatory responses.”

**Over-Voting and Under-Voting** (Page 35). The Commission indicated that it is considering whether broker-dealers should publicly disclose the allocation and reconciliation methods used by firms during each proxy season. The Commission is also exploring whether it would be beneficial to investors if broker-dealers were required to use a particular reconciliation method. In addition, the release asks whether investors, issuers, and the proxy system overall would benefit from having additional data from proxy participants regarding over-voting and under-voting.

**Vote Confirmation** (Page 40). In the Commission's view, “both record owners and beneficial owners should be able to confirm that the votes they cast have been timely received and accurately recorded and included in the tabulation of votes, and issuers should be able to confirm that the votes that they receive from securities intermediaries/proxy advisory firms/proxy service providers on behalf of beneficial owners properly reflect the votes of those beneficial owners.” The release indicated that the Commission is examining whether all participants in the voting chain should “grant to issuers, or their transfer agents or vote tabulators, access to certain information relating to voting records, for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder's shares were voted...This process could be fully automated such that a vote confirmation could be provided by the issuer (or its agent) to the record owner or, in the case of beneficial owners, to the securities intermediary or proxy service provider and sent by email to the beneficial owner.”

**Lack of Advance Notice of Meeting Agenda** (Page 45). The Commission is exploring whether the NYSE should be “asked” to “revise its rules to require public dissemination of a notice, in advance of the record date, that contains information about the record and meeting dates as well as specific descriptions of all matters to be voted upon. Other SROs could also be asked to adopt similar rules.” An alternative solution would be “a requirement for all issuers subject to our proxy rules to disclose the agenda by public means, such as by filing a report on Form 8-K (or as an alternative to such a filing requirement, permitting the issuance of a press release or a posting on a corporate Web site).”

**Disclosure of Voting by Funds** (Page 49). The Commission is examining “whether Form N-PX should be amended to require disclosure of the actual number of votes cast by funds.”

**Proxy Distribution Fees** (Page 58). The Commission has concluded that: “given developments in the securities market overall and proxy solicitation rules, such as the notice and access model, it appears to be an appropriate time for SROs to review their existing fee schedules to determine whether they continue to be reasonably related to the actual costs of proxy solicitation.” The Commission is considering changes to regulated fees on the grounds that “without a competitive market, there may be a continued need for regulated fees” (specifically citing lack of implementation by the NYSE of suggestions from the Proxy Working Group to “re-evaluate the NYSE's current fee structure”). Concepts under consideration include: “the creation of a central data aggregator that is given the right to collect beneficial owner information from securities intermediaries, but is required to provide that information to any agent

designated by the issuer”; and changes in fee structures driven by “some of the other potential regulatory responses discussed” in the release (“For instance, adopting a system under which securities intermediaries grant proxies to underlying beneficial owners...would permit issuers to negotiate fees and services with proxy service providers because the issuers would be directly soliciting proxies from those beneficial owners”).

**Issuer Communications with Shareholders** (Page 70). Reform of the OBO/NOBO (Objecting vs. Non-Objecting Beneficial Owners) system is under consideration. The Commission indicated that it is exploring the following concepts.

1. Issuers would be able to communicate directly with their beneficial owners by requiring broker-dealers and banks to execute an omnibus proxy in favor of their underlying beneficial owners and by eliminating the ability of beneficial owners to object to the disclosure of their identities to issuers (as presented in a 2004 Business Roundtable rulemaking petition and developed further in a 2009 letter from the Shareholder Communications Coalition). According to the release, “The system would identify all beneficial owners except those that elect to remain anonymous by registering shares in a nominee account.”
2. An “annual NOBO” system. In this system (quoting from the release): “an issuer would be entitled to a list of all beneficial owners, but only as of the record date for a particular meeting...At any other time during the year, objecting beneficial owner information would not be available to the issuer or any other party. An annual NOBO system would enable issuers to communicate directly with all of their shareholders, both registered and beneficial owners, for purposes of a shareholder meeting, while minimizing the possibility that the investor information will be used for purposes other than proxy solicitation, such as determining an investor’s trading strategies.” The SEC’s “annual NOBO” concept is based on a proposal from The Altman Group – as the Commission noted in Footnote 163 (Pg. 71). The latter includes a link to The Altman Group’s Oct. 2009 proposal titled “Practical Solutions to Improve the Proxy Voting System.” The original proposal from The Altman Group is available at <http://altmangroup.com/pdf/PracticalSolutionTAG.pdf>.
3. Steps to “promote selection of NOBO status,” such as “educating investors about OBO and NOBO status when they open their accounts or periodically.” The Commission noted that “while our rules contemplate that investors must object to disclosure of their identities to issuers, neither our rules nor self-regulatory organization (‘SRO’) rules currently require disclosure of the consequences of choosing OBO or NOBO status, or specify broker-dealer policies or procedures with regard to their clients’ choice of OBO or NOBO status.” The Commission is also examining: whether the default agreement used by all broker-dealers should be NOBO status; whether broker-dealers should be required to provide informational materials to their customers prior to allowing the customers to elect OBO status; and whether broker-dealers should “contact customers who elect OBO status periodically to re-elect their OBO/NOBO status.”

**Investor Education** (Page 78). The Commission is exploring additional steps to improve investor education concerning the proxy voting process and “the importance of voting.” The concept release cites the possibilities of: 1) having “more proxy-related educational materials located on an issuer’s or broker’s Web site”; 2) improvements to the “presentation of information on the proxy card or VIF”; and 3)

information about the shareholder voting process in “communications between brokers and their customers that occur in connection with opening customers’ accounts.”

**Enhanced Brokers’ Internet Platforms** (Page 80). The Commission indicated that it is “interested in receiving views on whether receiving notices of upcoming corporate votes and having the ability to access proxy materials and a VIF through the investor’s account page on the broker’s Web site would be helpful to investors.” The Commission is also exploring “whether other communications from broker to customer could encourage more active and better informed participation in the proxy voting process.”

**Advance Voting Instructions [“Client Directed Voting”]** (Page 81). The Commission, citing both its interest in increasing investor participation in the voting process and the potential value of “providing retail investors with a component of the services now made available to institutional investors by proxy advisory firms,” is exploring options for “client-directed voting.” The release covers a range of potential “issues” that would need to be considered, including: “the extent to which the investor’s vote is an informed one”; “whether...instructions should be re-affirmed on a periodic basis; whether they should apply to the voting of shares of issuers that the investor did not own when the original instructions were submitted; whether they should be re-affirmed each time an investor purchases additional shares of an issuer’s stock for which that investor has already submitted voting instructions; and whether brokers can seek from investors advance voting instructions that vary by company.” The release asks for recommendations concerning “any conditions or requirements that we should consider applying to the solicitation of such instructions.”

**Investor-to-Investor Communications** (Page 86). Citing an “understanding that there tends to be higher voting participation in situations that involve increased communications and high investor interest, such as well-publicized proxy contests,” the Commission indicated it is exploring “further steps...to facilitate informed discussion among investors” and “whether any additional forums for shareholder-to-shareholder communications would be helpful.”

**Improving the Use of the Internet for Distribution of Proxy Materials** (Page 87). Although the Commission has opened the door to further review of the notice and access model, the text of the release suggests a bias against further changes to the model. In February of this year the SEC issued a final rule on “Amendments to Rules Requiring Internet Availability of Proxy Materials,”<sup>2</sup> in which the Commission indicated that it was amending the model “to remove regulatory impediments that may be reducing shareholder response rates to proxy solicitations...statistics indicate lower shareholder response rates to proxy solicitations when the notice-only option is used.” In the concept release, the Commission now takes the position that: “it is difficult to conclude, based on existing data, that notice and access has caused changes in voter participation. To be sure, the number of retail accounts submitting voting instructions when issuers use the notice-only option is lower than the number of retail accounts submitting voting instructions when issuers use the full-set delivery option. The number of retail shares being voted, however, does not appear to differ substantially...it is difficult to discern whether patterns in voting behavior are due to notice and access or to other factors.” Moreover, while the concept release cites the “possible option” of permitting “the inclusion of a proxy card or VIF with the Notice of Internet

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<sup>2</sup> <http://www.sec.gov/rules/final/2010/33-9108.pdf>

Availability of Proxy Materials,” it goes on to note that the Commission “adopted a rule that prohibited the inclusion of the proxy card or VIF” after taking note of “commentators’ concerns that ‘physically separating the card from the proxy statement, as originally proposed, may lead to the type of uninformed voting that the proxy rules are intended to prevent.’”

**Data-Tagging Proxy-Related Materials** (Page 99). The Commission is exploring “whether it would be beneficial to investors to permit or require issuers, including funds, to provide proxy statement and voting information in interactive data format in addition to the traditional format.”

**Proxy Advisory Firms** (Page 120). The Commission is exploring ways to address concerns regarding a proxy advisory firm’s disclosures about conflicts of interest, including possibly: “Revising or providing interpretive guidance on the proxy rule exemption in Exchange Act Rule 14a-2(b)(3)...Exchange Act Rule 14a-2(b)(3)(ii) requires that a person furnishing proxy voting advice to another person must disclose to its client ‘any significant relationship’ it has with the issuer, its affiliates, or a shareholder proponent of the matter on which advice is given. It appears that some proxy advisory firms currently provide disclosure limited to the fact that the firm ‘may’ provide consulting or other advisory services to issuers...we could revise the rule to require more specific disclosure regarding the presence of a potential conflict.”

The Commission also indicated that it is seeking comments on: “whether proxy advisory firms operate the kind of national business or have an impact on the securities markets that Advisers Act Section 203A(c) was designed to address, and whether, as a result, we should establish an additional exemption from the prohibition on federal registration for proxy advisory firms to register with the Commission as investment advisers. We could also provide additional guidance, if necessary, on the fiduciary duty of proxy advisors who are investment advisers to deal fairly with clients and prospective clients, and to disclose fully any material conflict of interest. We also could provide guidance or propose a rule requiring specific disclosure by proxy advisory firms that are registered as investment advisers regarding their conflicts of interest, including, for example, on Form ADV.” Due to the “similarity between the proxy advisory relationship and the ‘subscriber-paid’ model for credit ratings,” the Commission is also exploring “whether additional regulations similar to those addressing conflicts of interest on the part of Nationally Recognized Statistical Rating Organizations (‘NRSROs’) would be useful responses to stated concerns about conflicts of interest on the part of proxy advisory firms.”

With regard to the “accuracy or transparency in the formulation of voting recommendations by proxy advisory firms,” the Commission indicated that it is exploring whether proxy advisory firms should: “provide increased disclosure regarding the extent of research involved with a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data. Proxy advisory firms could also disclose policies and procedures for interacting with issuers, informing issuers of recommendations, and handling appeals of recommendations. We could also consider requiring proxy advisory firms to file their voting recommendations with us as soliciting material, at least on a delayed basis, to facilitate independent evaluation by market participants of the quality of those recommendations.”

**Dual Record Dates** (Page 131). Citing recent “changes to state law,” the Commission is exploring: “whether to propose action to accommodate issuers that wish to use separate record dates where permitted by state law, and if so, what action we should take...we could choose between two general models, one focusing principally on the notice record date and the other focusing principally on the voting record date. The first model would be to require issuers to provide proxy materials or an information statement, as applicable, to those who are investors as of the notice record date. This model parallels the Delaware provision in that it focuses the information-delivery obligation on persons who are investors as of the notice record date. One open question under this first model is whether issuers should subsequently be obligated to send the disclosure document to those who were not investors as of the notice record date but who become investors by the voting record date. The second model would be to require issuers to provide the disclosure document to those who are investors as of the voting record date. An open issue under this model is whether and how issuers should be obligated to make the disclosure document public at some point before the voting record date.”

Under either model, the Commission indicated that it “would need to consider how the proxy or VIF already submitted by the investor would be affected, as well as the legal and operational implications that this situation may impose on broker-dealers and their customers.” In addition, the release noted that: “Investors may benefit from receiving information about the effect that trades subsequent to the submission of their proxy or VIF will have on their voting rights...One possible disclosure would be to establish that if an investor submits a proxy or VIF prior to the voting record date, all of the shares held by the investor as of the voting record date would be voted in accordance with the proxy or VIF, in the absence of specific contrary instructions from the investor. Another alternative would be to clarify that a proxy or VIF would not be used to vote more shares than the investor held at the time he or she submitted the proxy or VIF, so that shares acquired after the notice record date would not be voted unless that investor submits a separate proxy or voting instruction for those shares.”

**“Empty Voting” and Related “Decoupling” Issues** (Page 145). The Commission is exploring ways to improve transparency as a means of addressing empty voting “and related phenomena.” In particular, the release noted that: “The proxy rules, the periodic reporting system, and rules adopted pursuant to statutory provisions such as Sections 13(d), 13(f), and 13(g) of the Exchange Act might be modified or a new disclosure system could be developed to elicit fuller disclosure of empty voting...By improving transparency, investors would have the option to choose to respond to such information and make a better informed investment or voting decision. Issuers also may be in a position to take responsible and appropriate action in response to disclosure of empty voting strategies, such as increasing their solicitation efforts.”

The release cites “possible responses to empty voting and other types of decoupling that could be considered by the Commission, Congress, state legislatures, and individual issuers,” including steps to:

- “Require voters to certify on the form of proxy or VIF that they held the full economic interest in the shares being voted at the time the proxy was executed, or, if not, disclose the extent to which their economic interest in the shares was shorted or hedged.”

- “Require disclosure of the shareholder meeting agenda sufficiently ahead of the record date to enable investors who have loaned their securities to recall those loans to retain voting control of those securities.”
- “Permit only persons who possess pure long positions (i.e., economic interests not shorted or hedged) in the underlying shares to vote by proxy, or allow proxy voting only commensurate with their net long positions (e.g., economic interests after adjusting for equity or credit derivative-based hedging or short positions), or require a cooling-off period for those who have no or negative economic interests (after public disclosure) before voting.”
- “Prohibit empty voting, especially in situations where there is a negative economic interest.”

## **CONCLUSION**

The SEC's review of the U.S. proxy system carries the potential for major changes to the proxy voting process. We encourage companies to submit letters to the Commission on issues of concern to them. Please note that while the concept release excluded a number of issues and concepts that have been discussed by various organizations in letters submitted to the SEC over recent years, the Commission indicated in the release that it would “welcome comments on any other concerns related to the proxy process that commentators may have.” Comments are due on or before October 20, 2010 (SEC File Number S7-14-10).

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