

Proxy Reform FAQ

December 15, 2010

1. What are the major issues with the current proxy voting system?

The issues surrounding the regulatory shortcomings of the current system are numerous and complex, but they can be broadly categorized into four major areas:

- **Complex system with no competition.** There are two types of shareholders – registered and beneficial – which follow different procedures for receiving proxy materials and voting. This split causes unnecessary confusion and inefficiency. Adding to the problem is that a near-monopoly vendor controls more than 98 percent of street-side distribution and communication market, which hinders competition.
- **Inability to identify and engage shareholders.** The overwhelming majority of shares are held by beneficial holders, but issuers are not able to directly communicate with those holders. The regulatory relic of NOBO/OBO, rather than issuer or investor preference, have kept this system in place.
- **There's a lack of system-wide vote integrity.** There is no industry standard for the vote reconciliation process, which can lead to over- and under-voting. Under the current structure it is impossible to audit all proxy votes. Furthermore, the use of a voting instruction form (VIF) by beneficial shareholders instead of a proxy card leads to confusion and misinformation.
- **Issuers are subject to expensive, non-negotiable fees.** Fees for beneficial holder data aggregation and mailing of proxy materials and other communications are set by a regulatory body, rather than competitive forces. The SEC has also noted that Broadridge, the near-monopoly for proxy communication and distribution, charges the maximum allowable fees as a matter of routine.

2. In simple terms, how should proxy plumbing be reformed?

There are a number of common-sense solutions to the problems outlined above:

- **Open the market for proxy distribution and communications to fair competition.** Aggregation of beneficial shareholder data should be conducted by a regulated, not-for-profit industry utility (like that which is already used for mutual fund investors). Qualified vendors would then be able to compete for distribution and communication services based on their ability to meet issuers' needs. There are many possible options for the role of data aggregator, and several in the industry have proposed housing such a hub at the DTCC.
- **Eliminate NOBO/OBO.** Allowing issuers to directly communicate with shareholders – especially through the use of modern communications technologies – will improve proxy voting participation and allow for more frequent, robust engagement among issuers and shareholders.
- **Standardize vote methodology.** Reconciliation must occur before an intermediary transmits record-date beneficial owner information to the data aggregator and before proxy forms are mailed. All shareholders should be able to vote using a legal proxy card and vote results should be subject to both internal and third-party audits.

3. In a reformed market, what are the benefits to investors, issuers and intermediaries?

For issuers:

- **Efficiency.** By creating a unified system with one set of rules that reflects the market realities of 2010, issuers will be able to save money and reach their shareholders more effectively and efficiently in order to execute their corporate goals.
- **Improved communication.** Issuers will be able to directly contact their shareholders and communicate important company information. Taking advantage of modern communications technology, issuers will be able to provide more information to shareholders at a minimal cost.

- **Accuracy.** The proposed rule changes would create uniform shareholder voting by eliminating the VIF for beneficial shareholders and instead providing a legal proxy card. The streamlined voting system will also ensure more accurate vote tabulation. Eliminating the VIF will allow for clearer communications to shareholders and potentially higher levels of voting.
- **Savings.** A [study](#) the STA released in October 2010 analyzed the invoices for issuers of varying sizes. The results showed that issuers can expect cost savings of anywhere between 20 percent and 71 percent.

For investors:

- **Meeting attendance.** We believe the reforms we support will make meeting attendance and participation by beneficial holders easier, as they will have a legal proxy card rather than a VIF. Opening the market to competition should also lead to an advance in innovative products for both issuers and shareholders – such as virtual meetings and robust electronic communications.
- **Clarity.** Proxy materials and vote cards will be customizable and produced in plain English, with the elimination of the VIF, allowing for a more clear presentation and better understanding of important initiatives. Shareholders will be in a better position to align themselves to the issuer
- **Privacy.** Beneficial shareholders could remain anonymous through nominee or custodial accounts.

4. **The proxy plumbing system seems to be working pretty well. There haven't been any major issues. Why risk the change?**

For starters, there have been some major issues. In recent years, a number of proxy votes have been marred by validity issues, most notably Yahoo's 2008 director vote. There have been a number of other vote validity cases in the news in recent years.

Additionally, there is a wealth of anecdotal evidence that proxy vote issues are systemic, but due to the lack of transparency in the process, issuers aren't able to know all the details of what happened during the voting process; they simply receive the final report. Due to increased shareholder activism and closer vote results, the need for accuracy is critical.

Any system that charges issuers 20 to 70 percent more on cost than they would be charged in a competitive market is clearly not "working pretty well." A near-monopoly operates at the heart of the U.S. proxy system and issuers are losing out in both cost and lack of innovation.

5. **If NOBO/OBO is eliminated, how will investors maintain privacy? Who will pay for investor rights to privacy?**

Those investors who wish to remain anonymous would be able to do so through the use of a nominee or custodial account. Any fees associated with establishing a nominee or custodial account are between the investor and the custodian.

6. **How did Broadridge build its near-monopoly on shareholder information?**

Short answer: Regulators in the mid-1980s wrote a monopoly into the rules.

Long answer: In 1984, the NYSE established a committee to identify a beneficial owner communication process that would resolve cost issues and develop an effective, non-burdensome system. As a result of this effort, the committee determined that a central organization should be tasked with aggregating the data to ensure consistency in data preparation. The organization selected by regulators was the Independent Election Corporation of America (IECA).

In 1992, IECA was acquired by Automated Data Processing. Throughout the '90s, ADP continued to acquire proxy and data processing firms to bolster its control of the market. In 2007, Broadridge Financial Solutions was born of a spin-off from ADP that included IECA.

In essence, Broadridge built its near-monopoly by acquiring a company selected by a committee of regulators to serve as a single source of beneficial shareholder data aggregation. The decision to give central aggregation authority to IECA was made in 1985, before the information technology boom and at a time when beneficial holders made up only about 25 percent of all shareholders (today they represent 70 – 80 percent).

7. Does the current proxy voting structure create voting integrity issues? How would an open market improve voting reliability issues?

Yes, the current proxy voting structure creates voting integrity issues. An open market could make this less likely. There have been instances in which the information provided on a VIF differed from that on the legal proxy card, leading to inconsistencies in tabulation. If the proxy system were changed to make it easier for issuers to use a single entity for printing and mailing to both registered and street holders, such inconsistencies would not occur.

Another example: The elimination of broker discretionary voting leads to tighter results. According to data compiled for the 2010 Annual Corporate Governance Review prepared by proxy solicitor Georgeson Inc., there were nine instances in which director nominees received between 45% and 49.99% of the votes cast in favor. In each of these cases, there were also significant broker non-votes. Reforming the proxy system to enable full disclosure of shareholder positions would enable issuers to solicit votes directly from a wider range of investors, without relying on the broker vote.

8. How would the new system work? Who would aggregate beneficial shareholder data and has anyone stepped up to offer that service?

A third-party, not-for-profit data aggregator “hub” is a major part of possible reforms to the proxy system. Today, issuers must work with, and pay, the provider chosen by the banks and broker dealers – without any ability to negotiate the service contract.

The data aggregator concept shows there is a logical way to separate the beneficial data information aggregation and the proxy distribution processes into two distinct functions, enabling a neutral third party to act as the beneficial data aggregator and providing the issuer the ability to choose a proxy distribution service provider and negotiate the fees.

The DTCC seems like the logical entity to act as the information aggregator. A subsidiary of DTCC, NSCC, already serves the role we are proposing, acting as the data aggregator in the mutual funds industry. While other third parties can be considered for taking on the role of acting as the operator of the hub, there are clear advantages if DTCC performs this role. The report reinforces the findings of our October 2010 report that unbundling these separate functions will lead to significant cost savings and promote increased communication with beneficial holders. Aligned with other aspects of proxy reform, the data aggregator would lead to lower costs for issuers, greater transparency, accountability and auditability for voting – benefitting investors and issuers alike.

9. The “hub” concept report says it may cost approximately \$1.5 million to create a viable alternative to the current proxy distribution system. Why don’t the TAs just go for it seeing it is a relatively small amount?

It would cost that much only if the existing infrastructure of the DTCC were to be used and modified. This is not the cost of building a completely new system, which is not necessary. Currently, fees for proxy distribution are established under New York Stock Exchange Rule 465. DTCC is the logical choice to perform this role, given it is

the custodian of all immobilized securities held for the benefit of DTCC participants and their customers in “street name” form; it has the market standing, regulatory position and trusted network in place to act as a hub between intermediaries on the one hand and issuer agents on the other.

The investment in modifying DTCC’s technology is estimated to be less than approximately \$1.5 million, a relatively small amount for an industry that spends hundreds of millions on proxy distribution each year.

10. Wouldn’t the system be less reliable and less efficient with more service providers?

The new system, if properly implemented, would be more accurate and more efficient. Under the current structure, the market is split, with different systems for registered and beneficial holders. This split requires separate processes for reaching shareholders during the proxy season. By creating a single system with one set of rules, issuers will be able to save money and more effectively reach their shareholders. Other efficiencies through an open market that will be achieved:

- Communication with all shareholders through elimination of NOBO/OBO
- Streamlined voting process and enhanced accuracy by eliminating the VIF and allowing all shareholders to vote with a proxy card
- Cost savings through prices set by competitive forces, rather than regulatory fiat

11. Isn’t it more efficient for brokers to vote on behalf of their clients? Isn’t that one of the reasons why an investor would use a broker – to make their lives easier?

Brokers can automatically vote uninstructed retail shares on a handful of routine items. No permission is required from the shareholders. On non-routine items, only instructed shares can be counted. Under the various proposals for implementing a Client Directed Voting (CDV) system, shareholders would be able to provide their broker with standing instructions on how to cast their votes.

12. Is it true that transfer agents are the only groups pushing for change as they are trying to get a bigger piece of the pie?

Many different types of service providers could benefit, just as issuers and shareholders would, if there were not a near monopolistic proxy distribution system.

Transfer agents are just one of over 20 categories of groups pushing for change. Institutional investors, corporate issuers, retail investors, academics, lawyers, various industry organizations, and many more are all pushing for change.

Out of the several hundred comment letters sent to the SEC on their concept release on the U.S. proxy system, less than 10 letters came from transfer agents and their industry organizations.