October 28, 2019

The Path to End-to-End Vote Confirmation

REFERENCE DOCUMENT
Validating Proxy Voting Entitlements and Confirming Votes

Broadridge®

Background
The Path to End-to-End Vote Confirmation

- **July, 2010**: The SEC issued a *Concept Release on the U.S. Proxy System*. The Release requested comments on end-to-end vote confirmation.
- **August, 2011**: The Weinberg Center for Corporate Governance convened a Roundtable to make recommendations. *Refer to "Report of the Roundtable on Proxy Governance: Recommendations for Providing End-to-End Vote Confirmation, August, 2011."*
- **2014 – 2015:** The Roundtable's recommendations were validated by a Steering Committee in pilots with 50+ issuers.
- **May, 2016:** The Steering Committee concluded, "There are no impediments to issuers in providing the added assurance." *Refer to Announcement of the Securities Industry End to End Vote Confirmation Steering Committee , May, 2016.*
- **2018 – 2019:** Representatives of various participant groups voiced support:
  - Participants in the SEC's November 15, 2018 panel on proxy voting mechanics
  - Signatories to a *February 14, 2019 letter to SEC Chair Jay Clayton* (Society for Corporate Governance, SIFMA, Council of Institutional Investors, and Broadridge)
  - SEC Investor Advisory Committee, recommendations made on September 5, 2019.
- **March, 2019:** Based on discussions with issuers, institutional investors, broker-dealers, and others, Broadridge identified five key activities to make end-to-end vote confirmation a reality for all shareholders. The activities are consistent with recommendations of the Roundtable. *Refer to Broadridge letter to SEC Chair Jay Clayton, March 27, 2019.*
- **October, 2019:** With encouragement from the SEC, a Working Group was formed to move it forward. It is co-chaired by Darla Stuckey (Society for Corporate Governance) and Ken Bertsch (Council of Institutional Investors).

Overview
Processing Shares Held Beneficially in "Street" Name

- In this document, we provide answers to frequently asked questions about processing and reporting votes for shares held beneficially in street name, including:
  - What are the differences between how *proxies* are processed and how *securities* are processed?
  - What issues can arise from complexities in *securities transaction* processing and in the communication of *omnibus proxy information?*
  - How are voting entitlements managed and reconciled *in practice?*
  - Why is it that the *dividend* process and the *proxy* process are not interchangeable?
- The system for processing shares held in street name is governed by a patchwork of rules and regulations (federal, state, self-regulatory organizations, etc.).
  - The technologies, intellectual capital, and processing details necessary to make the rules and regulations work *in practice* may contribute to a perception that the proxy system is "unnecessarily" complex.
- As we illustrate below, there is an inextricable connection between the proxy system and the securities processing system.
  - The proxy system reflects and interfaces with the complexities and robust features of the clearance and settlement system. It does not and cannot operate as a freestanding voting system apart from securities processing.

Note: Although less complex in theory, the proxy system for "registered" shareholders (i.e., whose shares are held through transfer agents) has other challenges, as discussed below.

Overview
Validating Proxy Voting Entitlements and Confirming Votes

- As we illustrate below, there can be isolated voting discrepancies when there is a disconnect between a stock record and a voting entitlement. The discrepancies often go unaddressed in uncontested meetings when majorities of votes in favor of directors' recommendations are attained and there is no opposition party. (The Appendix to this document provides a list of examples.)
- Tracking and ensuring proper entitlements -- and reconciling the various accounts -- are the threads that tie securities processing and proxy processing together.
- The five essential steps for end-to-end vote confirmation are outlined below. These include such activities as: improving the process by which issuers request and receive securities position reports and omnibus proxy information; communicating and reconciling discrepancies soon after Record Date; and, confirming votes back to nominees and shareholders.
- While custodian banks and broker-dealers (together "nominees") and their processing services agents play an important role, other industry participants such as central securities depositories, issuers, funds, transfer agents, and solicitors are also involved in end-to-end vote confirmation.
- Broadridge is committed to supporting the Working Group in moving forward.

"Vote confirmation will enhance the integrity of the proxy process by providing investors assurance that their votes have been timely counted and voted as instructed." *Announcement of the Securities Industry End to End Vote Confirmation Steering Committee , May, 2016.*

Outline of this document:
Four sections (with additional details in the Appendix)

1 Securities Processing	2 Proxy Processing	3 Comparison of Dividend vs. Proxy Processing	4 Recommendations
Complexities in the U.S. clearance and settlement system create complexities in the proxy system.	"Complexities in trade transactions" and "Communication of omnibus proxy information" are examples of two issues that can arise.	Proxy processing and dividend processing are not interchangeable. There are differences in flows, timing, "fungibility," and reconciliation.	End-to-end vote confirmation can be accomplished with five activities *and* with the participation of all entities in the process.

1. Securities Processing

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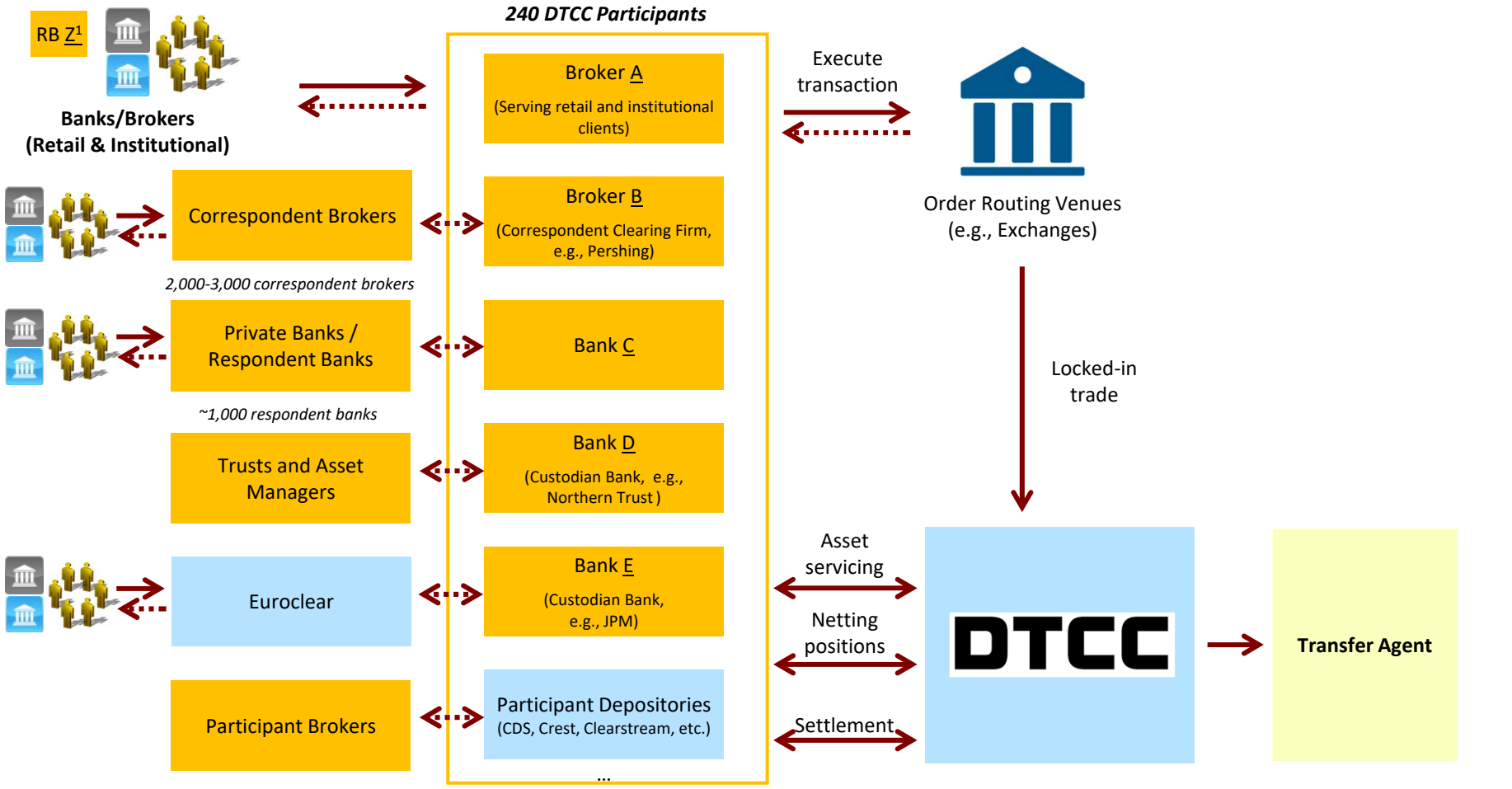
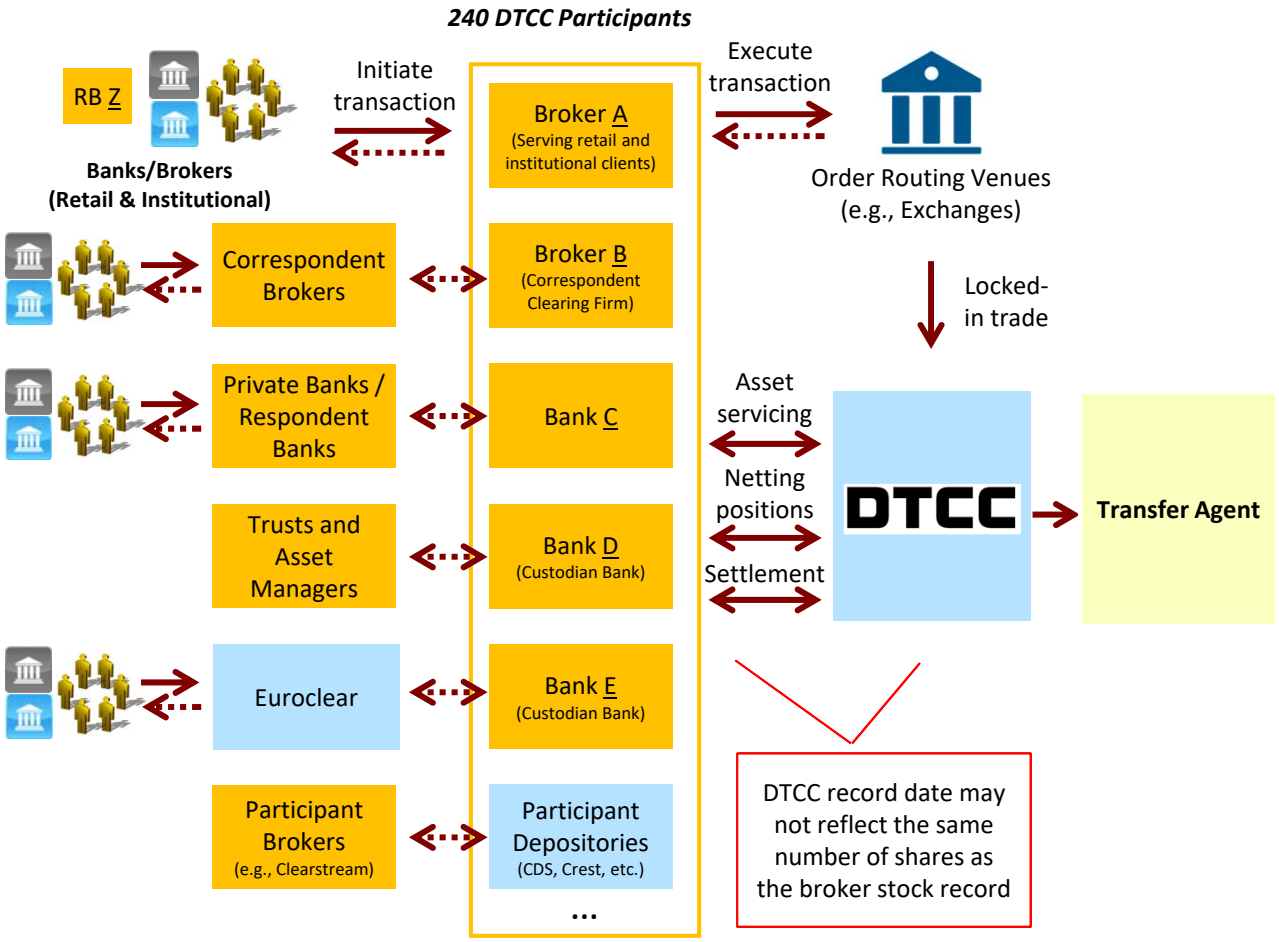
Securities processing

High-level, conceptual depiction of the process (not all participants and steps are shown).



1. Respondent Bank Z to be used in examples found below.

Issue 1: Complexities due to timing, exceptions, and normal course of transactions that require firms to reconcile positions.



The example on the following page illustrates the complexity.

- The right to participate in a proxy event is based upon settlement date.
- DTCC establishes the nominee-level entitlement based on the number of shares held on Record Date.
- Nominees are currently not required to identify where all of their shares are held for a given registrant as of Record Date, e.g., in the Canadian Depository for Securities (CDS), Euroclear, or safekeeping certificates,[1] etc.
- The process overall is well managed and highly automated…
- …however, there are three broad reasons for disconnects between stock records and voting entitlements:

1. **Normal course of transactions:** Stock lending, short selling, stock hypothecation[2]
2. **Timing:** Securities in transit (from ACAT, vault, re-registration), items in suspense
3. **Exceptions:** Failed settlements, failed recalls from securities loan

(Refer to the Appendix for details)

1. Client can hold certificated shares themselves, at the agent (DRS), or in the bank-broker's vault. 2. Securities pledged to collateralize bank loans

Example: Complexities in securities processing illustrated by an example of Broker A's entitlements.

For a given Broker A, the stock record reflects 100,000 shares, the DTCC entitlement is 75,000 shares, and the actual voting entitlement is 71,000 shares. Proxy materials and VIFs are sent to clients holding 97,000 shares.

I Stock record shows 100,000 shares vs. voting entitlements of 75,000 shares (DTCC) and 71,000 shares (actual)

100,000 shares in Stock Record for Broker A	
50,000 shs	Cash accounts for 54 customers[1]
(–) 5,000 shs	Failed to receive from Bank C
50,000 shs	Margin accounts for 40 (retail) customers[2]
(–) 20,000 shs	Loaned to Broker B
= 75,000 shares shown as DTCC voting entitlement available to Broker A	
(–) 3,000 shs	Omnibus shares at Respondent Bank Z
(–) 1,000 shs	Legal proxy for meeting attendance in person[3]
= 71,000 shares represent the true adjusted voting entitlement for Broker A.	

Reconciling items to the broker's stock record reduce the voting entitlement. Total vote cannot exceed 71,000 shares.

Further details on proxy/voting are provided below.

II Voting instruction forms are distributed to holders of 97K shares.

- Broker A provides an Omnibus Proxy to the Issuer transferring the voting rights to the 3,000 shares to Respondent Bank Z.

100,000	**Broker A stock record**
(–) 3,000 shs	Omnibus shares at Respondent Bank Z
= 97,000 shares for Voting Instruction Forms (VIFs) sent to owners in Broker A.	
(–) 1,000 shs	Legal proxy attended in person
= 96,000 potential shares to be returned after legal proxy issued for voting in person	

Voted by Respondent Bank Z, by and for underlying beneficial shareholders.

Total vote cannot exceed 71,000 shares.

1. Shares can be pledged, kept in segregated accounts, etc. 2. The shares held in Broker A's margin accounts are fungible. 3. When a shareholder attends the meeting in person, Broker A provides a legal proxy after materials are sent and backs out the shares from the total available to vote by Broker A.

2. Proxy Processing

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Proxy processing:
a. Entitlement

The owner of the shares on Record Date has the right to vote.

Issuing Corporation

1,000,000 shares

Transfer Agent

Registered Shareholders
Known to the Transfer Agent, who acts as the record keeper

John Q.	3,000 shares
Jane P.	7,000 shares
Jim O.	44,000 shares
CEDE & Co.	946,000 shares [DTCC]
	1,000,000 shares

946,000 shs (inclusive of CDS)

Chain of Entitlement

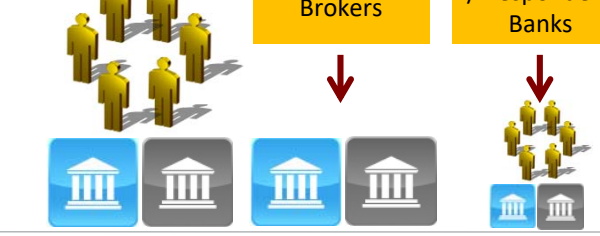
- DTCC provides an Omnibus Proxy to their Participants (banks and brokers)
- DTCC has ~240 Participants.
- Through this process, the Participants receive the voting entitlement for the shares held as of the Record Date.

DTCC

Entitlement Overview

- Beneficial shareholders are known to their Bank or Broker, who acts as the record keeper.
- The account positions as of the Record Date are entitled to vote and receive proxy information electronically or via paper.
- Shares held by a broker for the beneficial shareholder are fungible.
- Lending from margin accounts is not visible to retail shareholders[1].
- Votes go with the shares.

Broker A	*Broker B*	*Bank C*	*Bank D*	*Bank E*	*Participant Depositories*	Etc.
75,000 shs	171,000 shs	300,000 shs	100,000 shs	200,000 shs	100,000 shs	...
RB Z	Correspondent Brokers	Private Banks / Respondent Banks	Trusts and Asset Managers	Euroclear	Participant Brokers	



1. Differences between retail margin account holders and institutional lending

Example: Entitlement vs. voting

Distributing VIFs

Broker A

1. Voting instruction forms are sent to 54 cash account holders that represent 47,000 shares.
2. Voting instruction forms are sent to 40 margin account holders that represent 50,000 shares.

RB Z

VIFs are distributed to a total of 94 account holders representing 97,000 shares.

Less the Legal Proxy for the holder of 1,000 shares (subsequently backed out.)[1]

Voting

Issuing Corporation

1. The maximum number of votes from Broker A's beneficial shareholders is 71,000 shares.
2. 1,000 shares are voted with a Legal Proxy.
3. 3,000 shares are voted by Respondent Bank Z by or for underlying beneficial owners.

RB Z

Voting total maximum of 75,000 shares (held at DTCC).

Further details are found below.

1. Due to the 1,000 shares Legal Proxy for in person voting

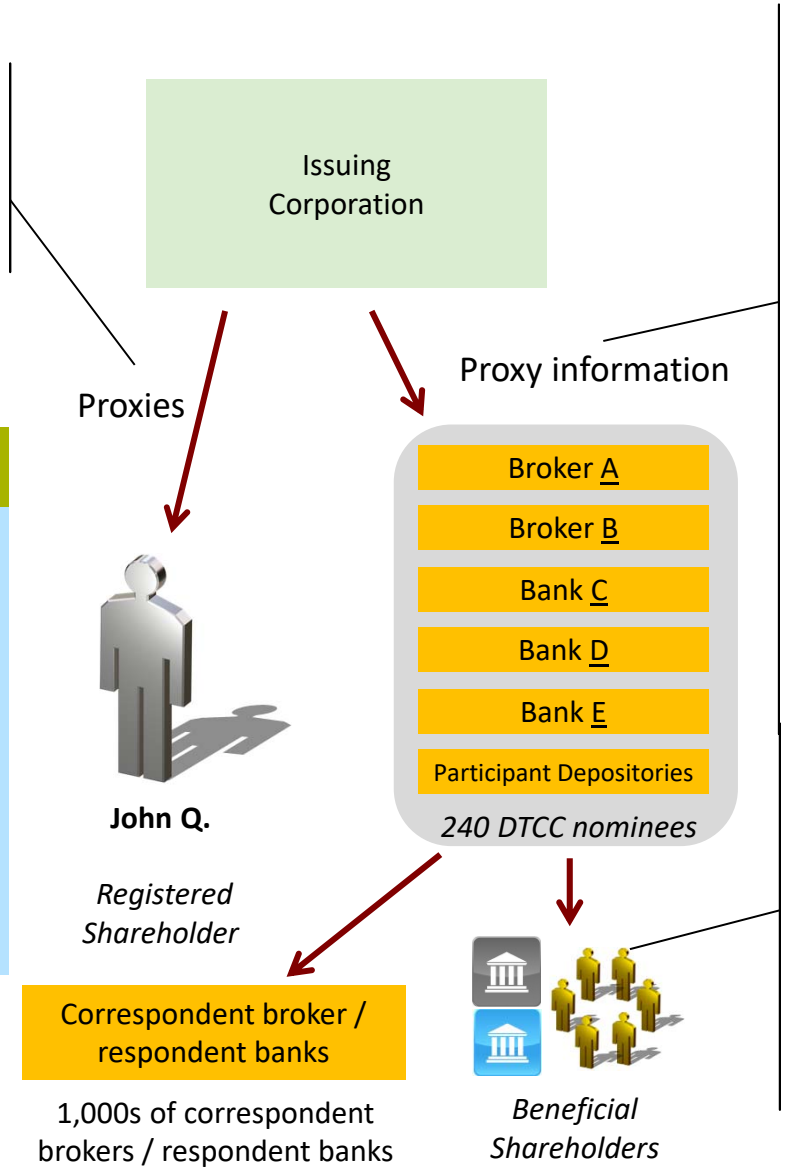
Proxy processing:
b. Communication to shareholders

- Issuing corporation sends proxies to registered shareholders.
- Registered shareholders are able to vote by proxy or at the meeting.

Background to enable process efficiency

Consents/delivery preferences and email addresses of shareholders are collected by the intermediaries – i.e., shareholders can sign up once with a broker and all issuers' materials are then delivered electronically to that account.

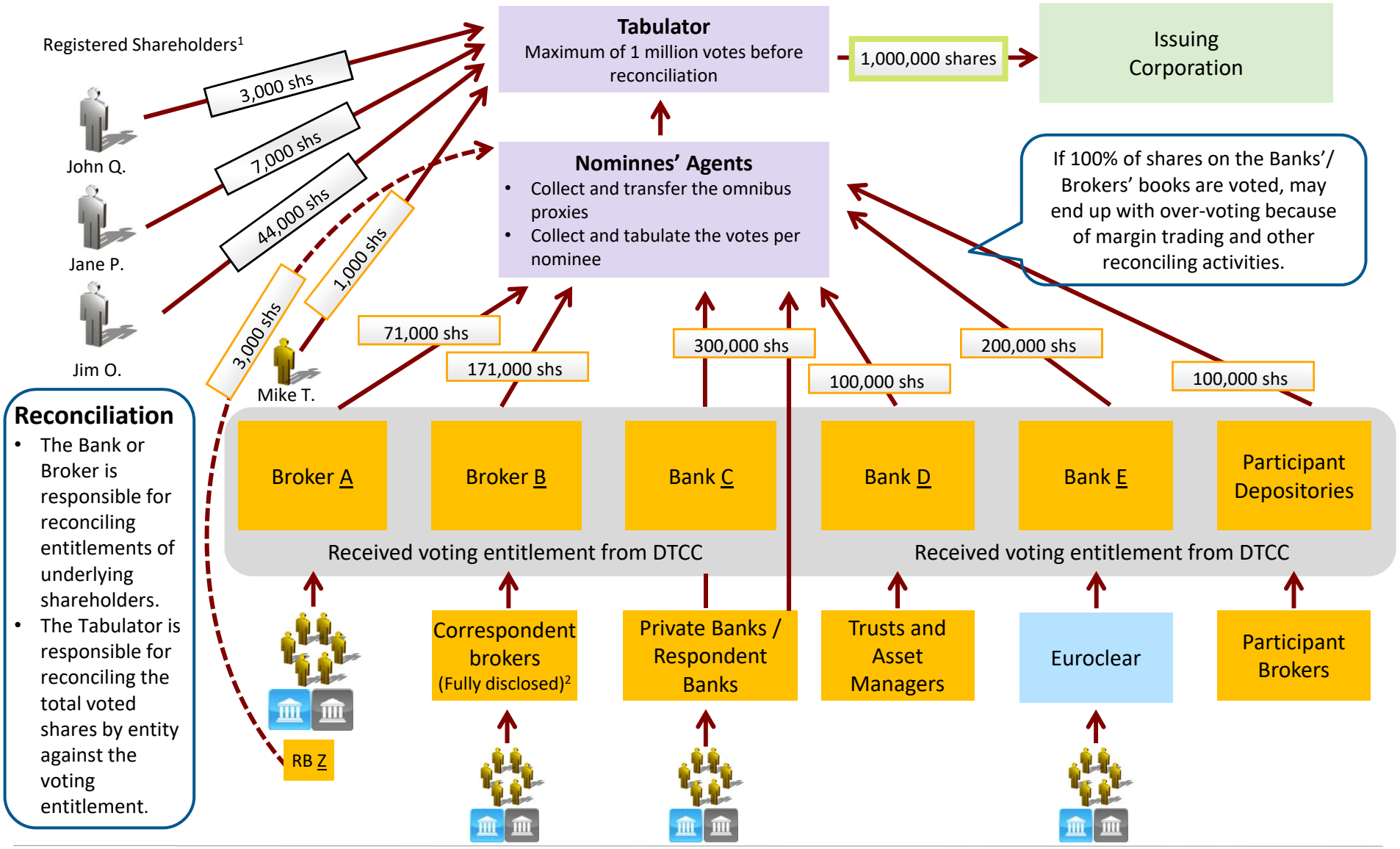
Agent of the broker solicits consents, collects consents as well as email addresses for email delivery, and creates websites to host proxy information as required by Rule 14a-16.



- Issuing corporation disseminates proxy solicitation information to the DTCC participant banks, brokers, and other Nominees (identified in the Omnibus Proxy) or their agents.
- DTCC participant banks and brokers, or their agents distribute information.
- In FY18, at the retail investor level, Broadridge delivered (after householding and managed account consolidations):
  - 56% by e-delivery
  - 31% by mailed notices
  - 13% by full packages
- Institutional investors receive all communications electronically.

- Banks or Brokers or their agents distribute the proxy information and Voting Instruction Forms (VIFs) to individual beneficial shareholders.
- Beneficial shareholders provide their voting instructions to their Bank or Broker or can vote at the meeting by obtaining a Legal Proxy.

Proxy processing: c. Share voting

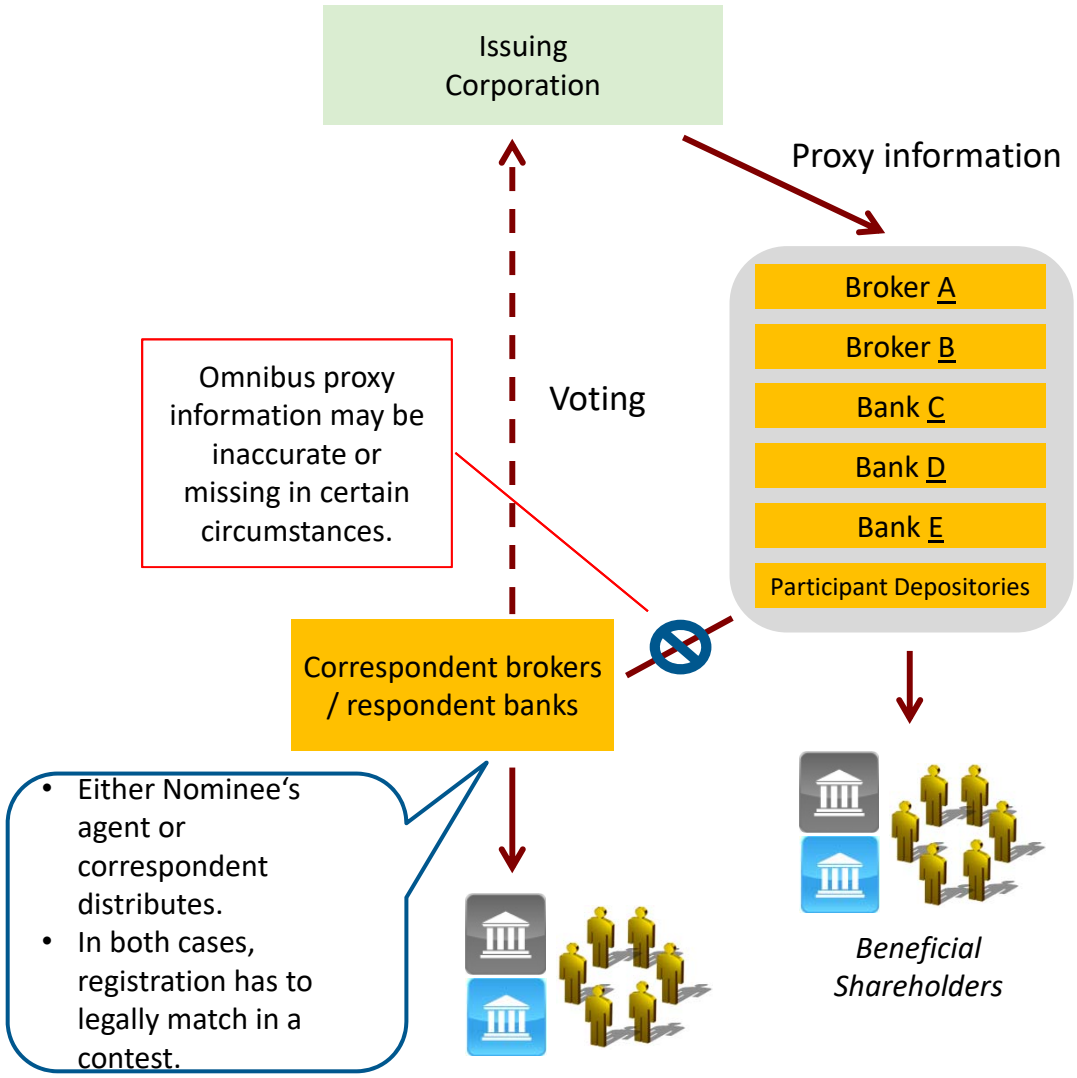


Reconciliation

- The Bank or Broker is responsible for reconciling entitlements of underlying shareholders.
- The Tabulator is responsible for reconciling the total voted shares by entity against the voting entitlement.

1. Certificated shareholders are treated in most circumstances like registered shareholders 2. "Fully disclosed" brokers use clearing firms to process accounts whereas a small number of "undisclosed" brokers are managed like respondent banks.

Issue 2: Omnibus proxies are not always communicated correctly to the processor, resulting in rejection of votes.



- Rule 14b-2 drives the identification of respondent banks and the issuance of omnibus proxies.
- Non-DTCC participants require an omnibus proxy from the record bank to identify the shares held by the non-DTCC participant.
  - Non-DTCC participants include trust banks and correspondent brokers that have beneficial shareholders not serviced by the record bank.
- **Problem #1:** A record bank may fail to update the file with a new respondent bank, and this may result in the issuer or its agent not accepting votes from fully entitled nominee accounts (in a contest).
  - Example: "Bank of Cayman" switches record banks from record bank X to record bank Y, and record bank Y fails to indicate need for an Omnibus Proxy.
- **Problem #2:** In certain instances, there may be a clerical error or failure to update a name change that will result in a name that does not match and that can be challenged in a contest.
  - Example: "Bank of Cayman" appears on the Record Bank's book *and* "Cayman Bank" appears on the Tabulator's records.

Example: Continuing the Broker A example -- three scenarios for how "post-reconciliation" can be applied in proxy processing.

Three scenarios for Broker A post-reconciliation

Recap of the example

- Broker A stock record is 100,000 shares:
  - 50,000 shares are in 54 cash accounts.
  - 50,000 shares are in 40 margin accounts.
- DTCC voting entitlement is 75,000 shares.
- Maximum vote from Broker A is 71,000 shares.

Scenarios

Scenario 1	29,000 shares voted	No additional action required.
Scenario 2	80,000 shares voted	Proportionately reduce 9,000 shares across the 40 margin accounts, conduct lottery, etc.
Scenario 3	96,000 shares voted	Proportionately reduce 20,000 shares across margin accounts less further 5,000 shares (for 'Receive vs. Payment' account fail from cash accounts).[3]

Reconciling votes to DTCC entitlements

In the example, if more shares were voted than are available and Broker A did not perform pre-reconciliation, it would need to work with its agent to perform post-reconciliation. Broadridge provides a service to prevent over-voting when post-reconciliation is the practice.

Alternatively, the broker can:

1. Contact those who hold the borrowed shares to obtain entitled proxies;
2. Ask proxy processor to increase their position by shares held at CDS, etc.

Reconciling votes

Adoption of a particular reconciliation process is generally based on the type of business the broker-dealer conducts (e.g., retail, high net worth clients, or institutional) and its philosophy as to which beneficial owners should be entitled to vote in the event of an imbalance.

Two methods for reconciliation: pre- and post-reconciliation:

1. Institutional firms generally use pre-reconciliation – identification of which investors are entitled to vote happens prior to sending the VIFs.[1]
2. Some retail firms use post-reconciliation – done after the broker-dealer's customers have submitted their votes. The broker-dealer will adjust the number of votes to correspond to its DTCC position. This process enables the retail broker to reflect the maximum number of beneficial owner votes.[2]

SEC perspective on reconciliation practices: In a 2007 SEC staff speech to the SIFMA Proxy Symposium, Erik Sirri, Director of Market Regulation, noted that there are several ways by which firms reconcile and allocate voting entitlements, based on their business model and customer base. He stated that the choice of which methodology to use is up to each firm, with the preferred solution being the disclosure of the methodology and consistent application of it. He noted that any regulatory initiative designed to address over-voting should be careful not to exacerbate the problem of diminished retail voting.

1. Many firms adjust records to reflect securities on loan. Fully-paid securities are given first priority and allocated a vote. To allocate any remaining votes among their margin account customers, the firms generally use a pro rata method. 2. In the rare situation when a retail firm needs to reduce the number of votes cast from the firm's position, they generally apply formulas to pro-rate margin shares on loan. 3. For the fail to receive.

3. Comparison of Dividend Processing and Proxy Processing

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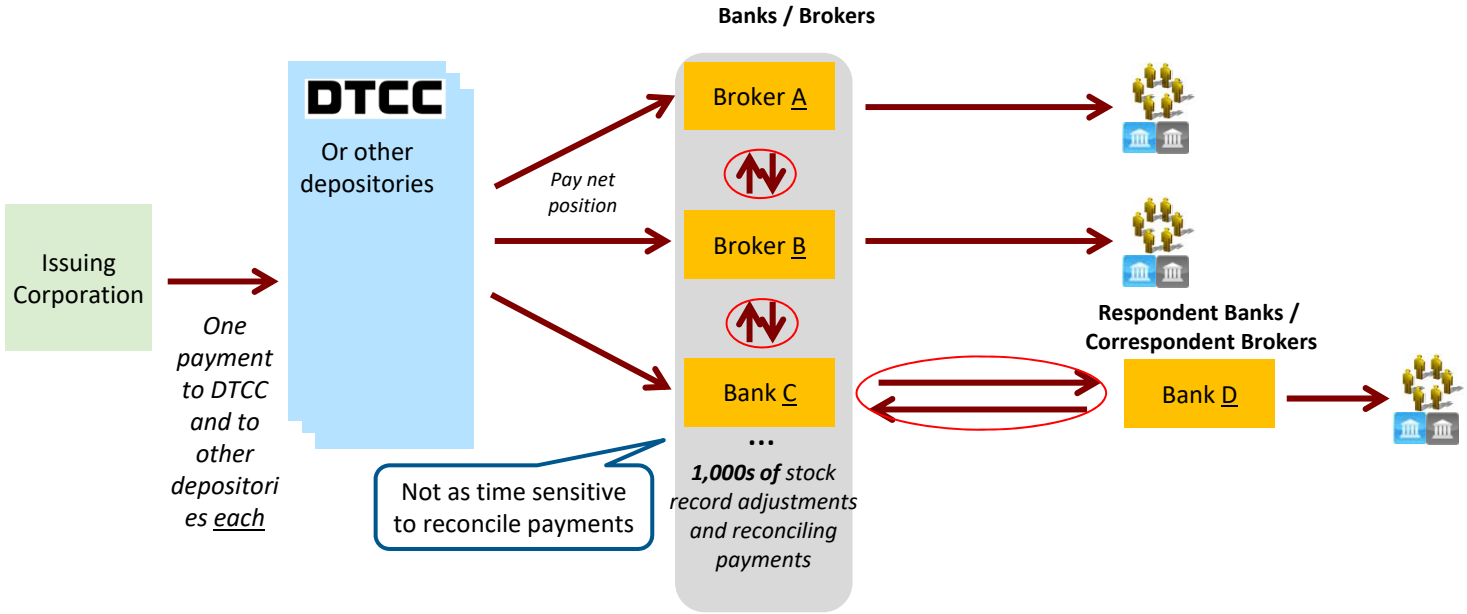
Complexities of dividend processing compared to proxy processing: *Dividend processing*

Proxies need to be reconciled to actual shares available. Dividends are paid in cash on payable date and can be reconciled subsequent to payment.

Dividend processing

- One-way flow
- Cash is fungible.
- Timing is not critical because parties are compensated, or made whole, and have the ability to settle claims over months.
- Broker stock record is accurate but claims will be made against dividends paid for failure to receive and other reconciling activities.

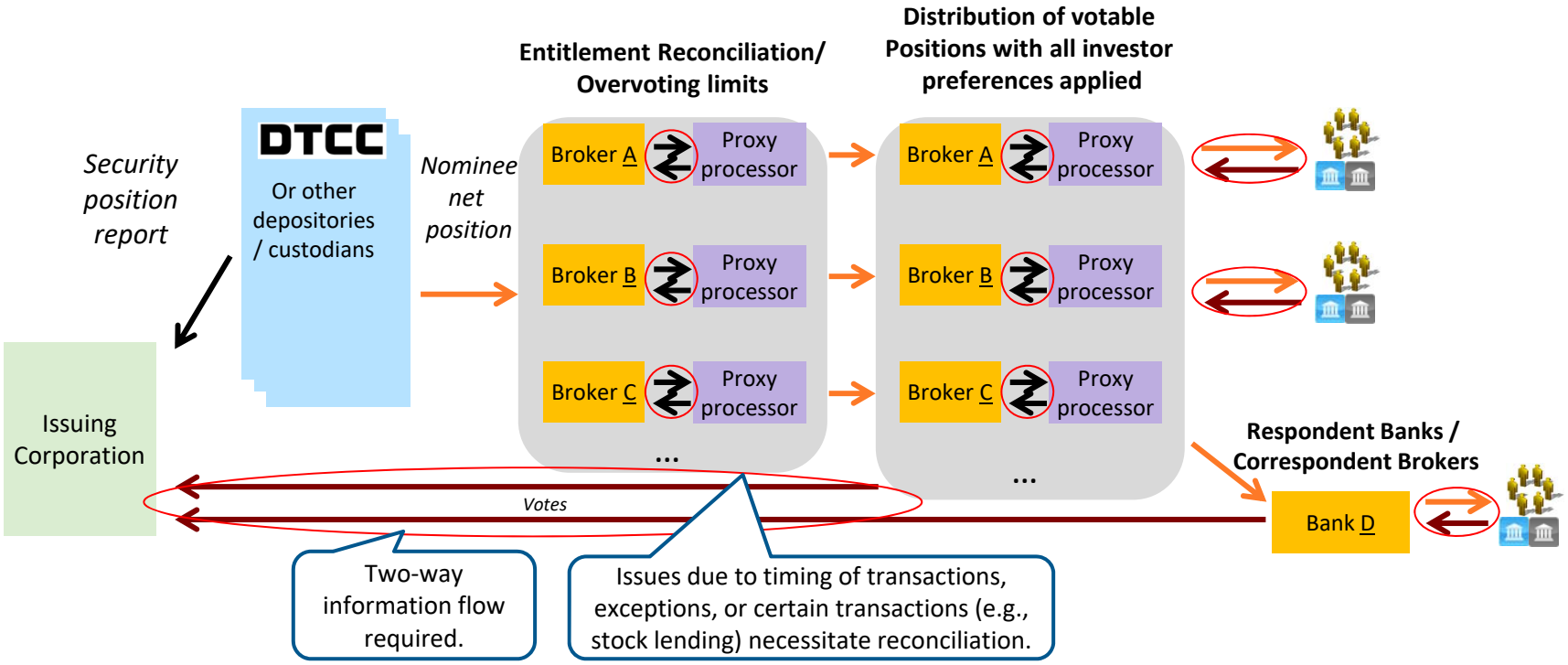


Complexities of dividend processing compared to proxy processing: *Proxy processing*

Proxies need to be reconciled to actual shares available. Dividends are paid in cash on payable date and can be reconciled subsequent to payment.

Proxy processing

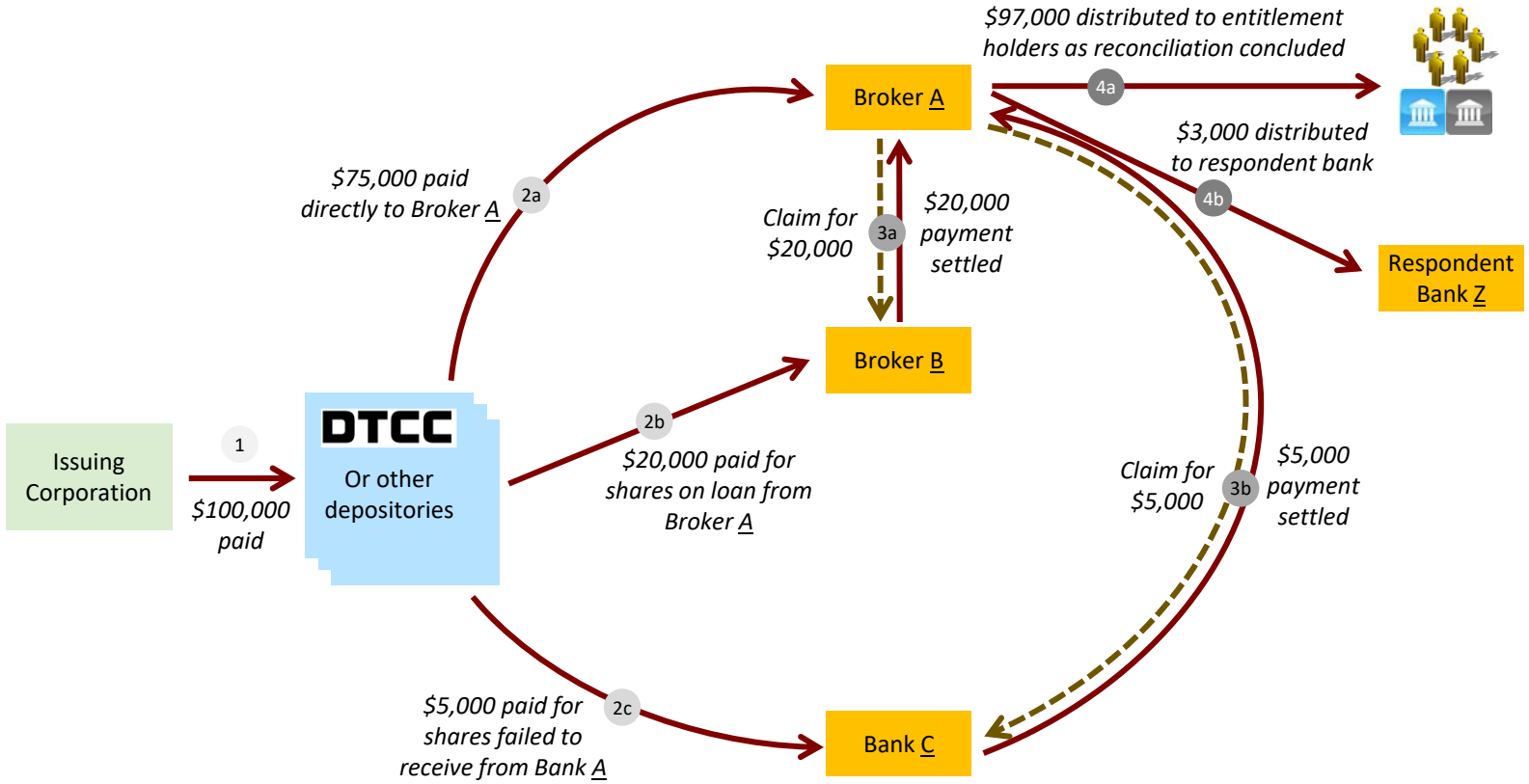
- Two-way flow
- Time sensitive; reconciliation process must be done and the votes reported as of the record date.
- Banks and brokers are required to remain within their voting entitlement.
- Retail investors do not typically vote 100% of their shares.



Example: Dividend processing for Broker A

Example from prior section – continued --

- DTCC entitlement is 75,000 shares vs. Broker A stock record of100,000 shares.
- Only the money flows related to the 100,000 shares are shown.
- Each share pays $1 dividend.
- Currently, dividend processing is a highly manual process.
- Payments to shareholders are made timely, but claims between brokers can take days, weeks, or months to resolve.



4. Recommendations to Enable End-to-End Vote Confirmation for All Shareholders

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Five key activities
Steps 1 – 3: *Validating Entitlements*

Recommendation	Description	Who	Rule	SEC Action
1. Improve the process by which Issuers request and receive Securities Positions Reports from Securities Depositories	• Issuers and their agents should insure that they request and receive reports not only from the Depository Trust and Clearing Corporation ("DTCC") but also from the Canadian Depository for Securities ("CDS"). • There is evidence that these reports are not always included in tabulator entitlement files.	Issuers	None specifically	Guidance
2. Improve the process by which Issuers request and receive Omnibus Proxy reports from Nominees – AND improve the process by which Nominees report their Omnibus Proxies	• In addition to the reports issued by Securities Depositories, Nominees also issue Omnibus Proxy reports for their respondents. Under SEC Rule 14b-2, custodian banks and broker-dealers are required to issue Omnibus Proxies for their respondent banks and/or brokers. • The reports must be forwarded to Issuers (or their agents) within five business days of a record date. • Broadridge and other agents for Nominees can facilitate the issuance of Omnibus Proxies on behalf of their clients. • The pilots underscored the importance of developing functionality to identify and communicate discrepancies early on in the process.	Nominees	Rule 14b-2	Educational Alert reminding banks and brokers of the requirement
3. Nominees must be timely notified by Issuers of discrepancies between the Issuer's entitlement records and those reported by Nominees (within 5 days of their receipt of the information).	• Issuers need to confirm vote entitlements with Nominees and notify them of discrepancies within five business days of their receipt of Record Date Position and Share Confirmation by Nominees. This step would flag reconciliation gaps well in advance of shareholder meetings so that they can be remediated. • Toward this end, the SEC might evaluate whether to amend its rules to facilitate this step. For example, the SEC might amend the instructions to Item 5.07 of Form 8-K to require a statement that reconciliation and inclusion of all shares received from Nominees was in fact, carried out -- or, if such reconciliation including all shares reported by Nominees was not carried out, an explanation as to why not.	Issuers	None specifically	Interpretive Guidance (of what's required to be disclosed in Form 8-K filings), or new rule

Five key activities -- continued
Steps 4 – 5: *Confirming Votes*

Recommendation	Description	Who	Rule	SEC Action
4. Issuers must confirm to Nominees that their votes are included, as cast, in the final tabulation.	• Issuers (and/or their agents) must affirmatively confirm receipt from Nominees (and/or their agents) of votes of shares held in street name. • They should indicate to Nominees (and/or their agents) that the votes were received and reported, as cast, at the shareholder meeting.	Issuers	None specifically	Interpretive Guidance (of what's required to be disclosed in Form8-K filings), or new rule
5. Nominees must confirm votes of their beneficial account owners; Issuers must confirm votes of their registered shareholders.	• Nominees must make confirmation available to their beneficial account owners. • After having received confirmation (as noted in step 4 above), Nominees (and/or their agents), should be required to make online confirmation available to their beneficial account holders. • Similarly, Issuers (and/or their agents) should be required to make online confirmation available to their registered shareholders.	Nominees and Issuers	None specifically	Interpretive Guidance or new rule

Proxy contests require steps to address shares held directly in registered form.

The five steps are essential building blocks for achieving end-to-end vote confirmation for *uncontested* shareholder meetings. *Contested* meetings require additional measures, given the roles opposing parties play in soliciting votes for their respective sides.

- Fostering greater confidence in the outcomes of voting by registered shareholders in contested solicitations requires additional measures by the SEC. That is because when "snake pits" are involved, the votes of registered shareholders are tabulated separately by opposing sides, *i.e.,* by an agent for management, and by another agent for opposition – both of whom want to win for their side.
- In the P&G / Trian proxy contest (2017), a "snake pit" was necessary to address the tabulation of registered shares (which represented approximately 6% of the shares outstanding).
- To advance vote confirmation with registered shareholders in contested solicitations, the SEC might consider requiring verification of the registered shareholder tabulation process by an independent third-party firm, *e.g.*, a major independent public accounting firm.
- The SEC could also require Inspectors of Elections ("IOE") to be involved at the beginning of the solicitation, instead of simply after the polls close. To be specific, currently in proxy contests, the IOE has no visibility into the handling of proxies of registered shareholder before the polls close.

Appendix: Further details and clarifications

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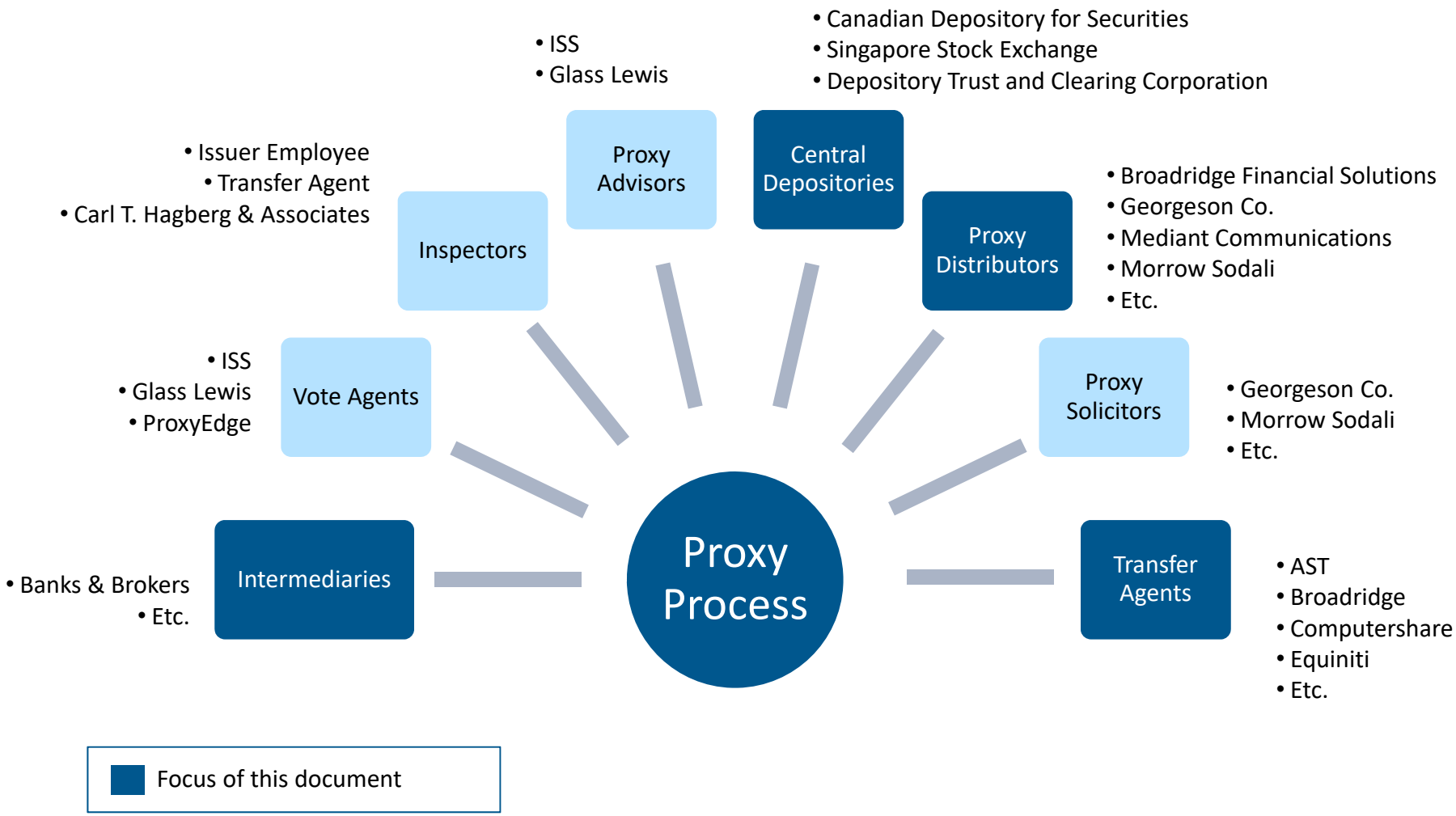
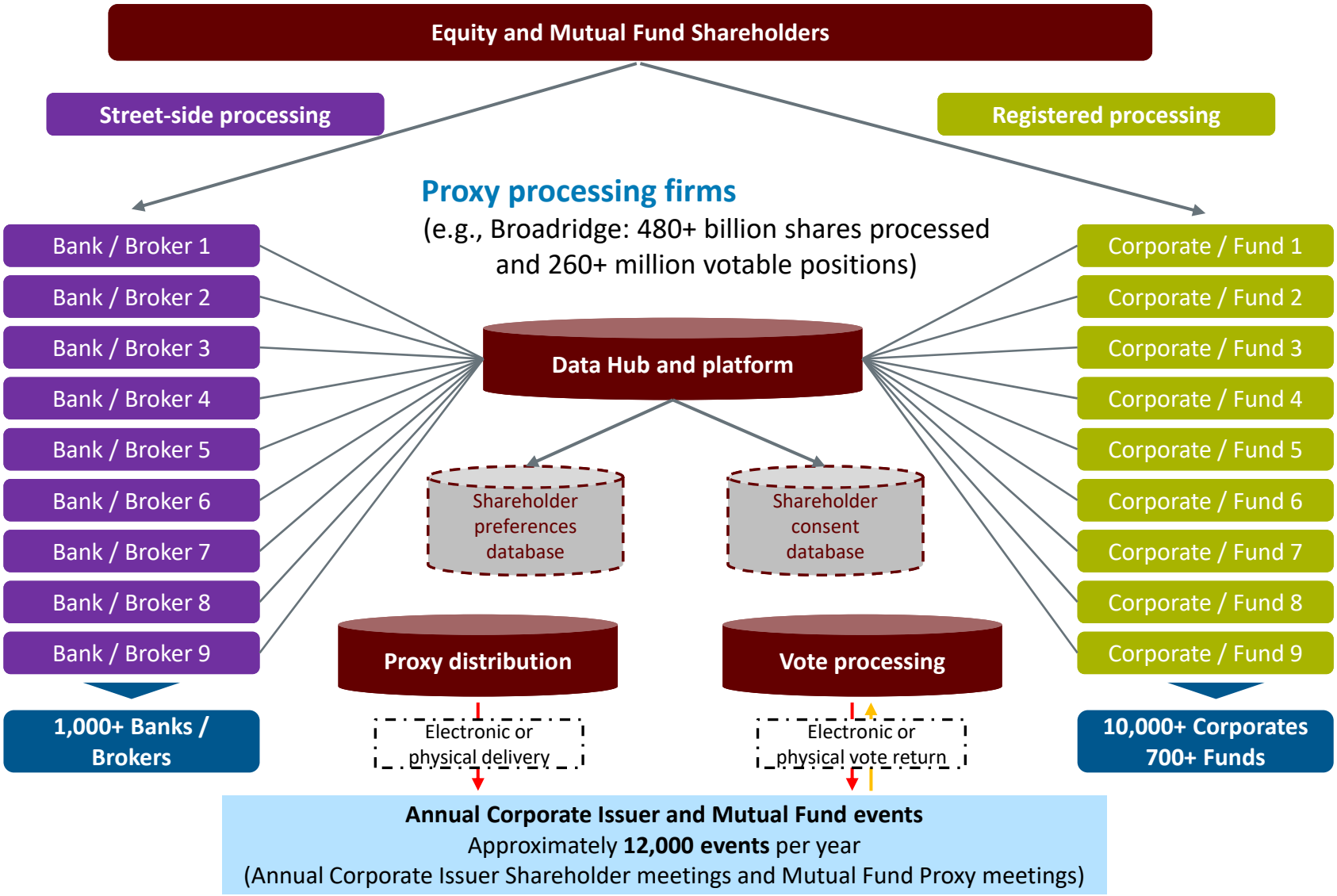
Further details on the potential reasons for a disconnect between stock records and voting entitlements

Potential reasons for disconnect		Description
Normal course of transactions	Stock lending	Brokers may reflect a client as entitled to vote even if the shares are on-loan to a counterparty or the loan recall failed -- as long as there is no over-vote.
	Short selling	To support short selling, brokers may need to borrow from retail investors / institutions to cover a settlement, thus impacting vote entitlements.
	Stock hypothecation	Brokers or dealers may hypothecate or lend collateral from margin customers and the position may not be reflected at DTCC. Clients retain the right to the vote even though shares may be located at another entity.
Timing	Securities in transit (from ACAT, vault, re-registration)	Shares that are in transit may not be reflected in the DTCC's entitled nominee position, even though the bank / broker and their client expect to have the right to vote (similar to a failed settlement).
	Items in suspense	On rare occasions, brokerage firms may have an out-of-balance condition on their stock record vs. the client entitled position – e.g., lost certificate.
Exceptions	Failed settlements	Clients who have purchased shares are entitled to vote even though their broker-dealer may not have received the shares from the counterparty, meaning this position is not reflected at DTCC.
	Failed recalls from securities loan (with no voting rights if overvote)	Similar to a failed settlement, a stock record will show entitlement based on what was supposed to happen as this allows the broker to follow up and 'claim' the market for what the client did not receive.
Omnibus	Omnibus proxy missing	Record bank may fail to update the file to the issuer with new respondent bank information – or record bank / broker may fail to update a name change, resulting in rejected votes.

Proxy Ecosystem
Examples of key players in the Proxy Voting process



Proxy & Non-proxy ("Interims") communications Processing overview -- "The Plumbing"