Folio Investing

FOLIOfn Investments, Inc.
8180 Greensboro Drive
8th Floor
McLean, VA 22102

p 703-245-4000
f 703-245-4800
folioinvesting.com

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Securities and Exchange Commission
100 F St., NW
Washington, DC 20549-9303
Rule-comments@sec.gov

RE: Release No. 34-69622, File No. SR-NYSE-2013-07

Supplemental Comments of FOLIO*fn,* Inc. concerning: Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name, and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform

Dear Securities and Exchange Commission:

FOLIO*fn* Investments, Inc. ("Folio") respectfully submits these supplemental comments concerning the above-captioned Release. These comments are in addition to the letter submitted on June 20, 2013 (copy attached) in the same matter (the "Original Letter"). Defined terms have the same meaning as in the Original Letter.

In our Original Letter we noted that the proposed NYSE rule would, by eliminating compensation for and, therefore, the delivery of, proxy materials to shareholders with five shares or fewer in a security in certain accounts (where such shareholder retains voting authority), effectively result in the disenfranchisement of those shareholders; and, similarly, the proposed rule would disenfranchise all shareholders who hold less than one full share, again where under applicable law such shareholders are entitled to vote.

We have since understood that the NYSE might take the position that although applicable Commission rules require that a firm be compensated for the "reasonable expenses" of proxy distribution – such distribution would still be required in these instances, although no compensation for reasonable expenses would be paid. In these cases, the reasonable expenses would be deemed "zero." We also understand that that position rests on the ground that the overall "average" compensation received by a firm for distribution of proxy materials to other shareholders with larger accounts[1] would compensate for the lack of reimbursement for reasonable expenses of distributing materials to these smaller accounts.

This supplement is being provided to respond to that position.

[1] Presumably, by definition then, the compensation to be received for distributing materials to larger accounts is higher than the expected average reasonable expense to balance the "zero" compensation for distribution to the smaller accounts.

First, we note the obvious: the costs for distribution to an account that holds, for example, three shares in a security is identical -- in absolutely all respects -- to the costs for distribution to an account that holds thirty or more shares. If the reasonable expense is "zero" for distribution to the account holding three shares it should be zero for the account holding thirty. Similarly, whatever reasonable expense is deemed to exist for distribution to the account holding thirty shares it should be the identical cost to be reimbursed for distribution to the account holding three shares.

Second, although for a dominant player, the "average" costs of distribution might, overall, be reasonably compensated by the tortured mix of complex fees in the NYSE proposal, that is not the case for any specific firm. We, for example, work hard to service smaller investors; other firms specialize in serving larger investors. On average, for a firm like ours, we would receive far below the "average" compensation and therefore not receive reimbursement for our reasonable costs, while a different firm would presumably be significantly over-compensated. If the argument is that the "average" reimbursement is reasonable, then why not have a simple per distribution fee that equals that "average" cost – for all distributions actually made regardless of number of shares held -- and eliminate all complexity and potential unfairness? By refusing to do that, the result is a proposal that does not conform to the Commission's rule to provide for reasonable expense reimbursement and which is unfair to both issuers and those making distribution.

Third, although the argument is that no disenfranchisement occurs because firms would still be required to distribute materials to all shareholders, even though distribution to some would not be compensated, the result is that smaller investors are materially disfavored. Either extra fees would need to be imposed for smaller accounts or smaller accounts would simply be disfavored with minimum account balances or activity fees or the like. Scale economics already dictate some of that reality, but to purposefully put in place a rule to encourage further discrimination against smaller investors would be bad policy.

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For the foregoing reasons and those contained in the Original Latter, Folio respectfully urges the Commission to reject the proposed rule changes at issue in the Release.

Respectfully submitted,

Michael J. Hogan
Chief Executive Officer
FOLIO*fn* Investments, Inc.

FOLIO*fn* Investments, Inc.
8180 Greensboro Drive
8th Floor
McLean, VA 22102

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Dear Securities and Exchange Commission:

FOLIO*fn* Investments, Inc. ("Folio") respectfully submits these comments concerning the above-captioned Release. Folio is a self-clearing registered broker-dealer that provides brokerage services to retail customers, registered investment advisers for the benefit of their clients, and other broker-dealers.

Folio provides its customers with various tools and means to invest in a smarter way: we seek to encourage investors to diversify, to invest according to their personal needs, to invest consistently, to mind fees and expenses, and to be tax aware. Specifically, among the unique attributes of the Folio platform, is the ease with which investors of all financial means, including advisors acting on their behalf, can implement an intelligent and well diversified portfolio strategy, which frequently results in smaller and even fractional share holdings in investors' accounts.

Folio also empowers investor participation in responsible corporate governance by enabling and facilitating shareholders' proxy voting. All of Folio's customers, regardless of whether self-directed or advised, *that retain voting authority over the securities in their account,* have access to and participate in Folio's state of the art electronic delivery portal for proxy materials and other key communications. The Folio portal has been available to investors since the company began serving them more than thirteen years ago.

Through this secure portal, Folio electronically delivers to its customers issuers' proxy materials, including one-click access to annual reports, full proxy statements, and a link to the issuer's website. The intent is that every shareholder with voting rights in a security can review the materials and vote their shares in an informed way. This is true regardless of how small or large the shareholder's position in that particular security may be.

The access to the portal is fully integrated into the Folio customer's account pages. It is accessed through one click from the customer's account, thereby facilitating access and participation in governance related activities. Each customer is also provided, by email to both a secure email box as well as to their external email address, direct notice of the issuer involved in the corporate action, the deadline for which action can be taken and the account of the customer in which the security is held. The portal also provides a means for any shareholder who wishes to attend a meeting in person, to request a legal proxy that can be downloaded and taken to the meeting, and a means to cancel that legal proxy if the shareholder subsequently wishes to vote by proxy through the portal.

As explained below, Folio urges the Commission to reject the proposed rule changes. Significant provisions of the proposed rule are not adequately supported by the facts of record nor are they supported by any adequate or persuasive rationale. In addition, aside from being internally inconsistent, the rule proposal is inconsistent with and violates the letter as well as the spirit of Regulation 14A ("Regulation 14A") under the Securities Exchange Act of 1934 (the "Exchange Act") including specifically Rule 14a-13, and Rules 14b-1 and 14b-2, and cannot be adopted. Moreover, adoption of the proposed rule would result in the unacceptable – and impermissible -- disenfranchisement of smaller shareholders. [1]

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[1] Folio also notes that there are a number of other parts of the proposed rule that are objectionable. We understand that some of these provisions are enlargements of items that hail from the existing rule's structure – nevertheless, we do not see that as justification to propagate provisions that would be objectionable now were the existing rule to be proposed and analyzed anew.

For example, the proposed rule would provide for an "Intermediary Unit Fee" (to replace the one that currently exists). But there is no rationale for an issuer to pay *extra* because certain nominees use an intermediary, as compared to those nominees that take on the full burden of satisfying those obligations directly. Presumably, the reason underpinning the use of an intermediary in the first place is that the intermediary is sufficiently more efficient at providing the required services that the overall cost of the activities taken by the intermediary – including the costs assumed by the nominees they service -- is less than the cost of a nominee taking the required delivery actions on its own. If, however, it is more costly to have the intermediary involved, then we should be aspiring to eliminate the intermediary altogether. Assuming it is less costly to have the intermediary involved, then the overall fees paid by the issuer should be less than – or at least certainly no more than -- the total of fees paid to nominees that act directly. This proposed rule, irrationally, turns that fact and rationale on its head – proposing to require issuers to pay additional fees, above those paid to direct nominees, when an intermediary is involved.

In summary:

- The proposed rule, by eliminating compensation for and, therefore, the delivery of, proxy materials to shareholders with five shares or fewer in a security, merely because such shares are held in a "Managed Account" -- without regard to whether the holder of such shares has retained voting authority over those shares – effectively results in the disenfranchisement of those shareholders.

- By contrast, the proposed rule reimburses for costs in connection with *not* distributing proxy materials in "Managed Accounts", when the shareholder has, in fact, delegated all voting authority to the manager.

- The proposed rule disenfranchises all shareholders who hold less than one full share, regardless of whether under applicable law such shareholders are entitled to vote.

- There is no support for the proposed changes in "reasonable expenses" for proxy distribution – instead they are simply the result of a bargain struck between a small group of select, interested parties together with the dominant proxy distributor.

- The proposal provides for unjustified and what we believe would be anticompetitive "incentive" payments – basically marketing payments for the dominant intermediary -- for brokers' adoption of the Enhanced Broker Internet Portal ("EBIP").

- The proposed rule is intended to be enforced industry-wide, including with respect to non-NYSE members and issuers not listed on the NYSE – but it is proposed as an NYSE rule. As an industry-wide rule adopted pursuant to Regulation 14A, then the Commission itself should implement appropriate rule-making to such effect, including in compliance with the APA, the Sunshine Act and other applicable laws.

Because of these flaws and for the additional reasons described below, the Commission should reject the proposed rule changes.

1. **Disenfranchisement of Shareholders with Five or Fewer Shares in a Security in "Managed Accounts".** The proposed rule change effectively disenfranchises shareholders who hold five or fewer shares in a security in a Managed Account as defined in the rule proposal. It would provide no reimbursement of costs for distribution of materials to such shareholders, which presumably means intermediaries would not be required to distribute such materials to those shareholders or would not be reimbursed if they did, both of which are in violation of Regulation 14A and specifically Rule 14a-13(a) and the notes thereunder and Rule 14b-1, *et. al*. This purported abrogation of a fundamental shareholder right, granted by state law and

supported by the current obligation to furnish materials to *all* shareholders *with voting authority*, is not permitted by governing law. [2]

The five-or-fewer threshold is also arbitrary; there is no discussion of whether any other higher or lower number would satisfy or better serve the law and the rules. The selection of more than five as the minimum number for which reimbursement will be provided is apparently reflective of the perspective of some large issuers, in agreement with big brokers that primarily service large accounts, "that, given the relative benefit/burden on issuers and brokerage firms, it is not reasonable to make issuers reimburse the cost of proxy distribution to managed accounts holding five shares or less." Aside from there being no support for the "relative benefit/burden" calculation, this rationale reflects a disregard for the interests of shareholders.

The Exchange Act and the applicable rules under Regulation 14A do not empower or permit any issuer, or any broker, dealer, bank, association, or the other entities specified therein to simply decide that certain shareholders are too small to matter, or that their interests can be disregarded and they simply shouldn't count – but that's what this proposed rule says and does.[3]

The proposed rule also takes the position -- based on no support presented -- that such disenfranchisement is warranted "due to the fact that almost all Managed Account investors delegate voting to the investment manager." But, it defines -- irrationally and arbitrarily -- Managed Account without regard to this supposed fact. Instead, it defines a Managed Account as:

> "[A]n account at a nominee which is invested in a portfolio of securities selected by a professional advisor, and for which the account holder is charged a separate asset-based fee for a range of services which may include ongoing advice, custody and execution services. The advisor can be either employed by or affiliated with the nominee, or a separate investment advisor contracted for the purpose of selecting investment portfolios for the managed account. Requiring that investments or changes to the account be approved by the client would not preclude an account from being a "managed account" for this purpose, nor would the fact that commissions or transaction-based charges are imposed in addition to the asset-based fee."

[2] See 17 C.F.R. 240.14b-1, *id*. 240.14b-2.

[3] A position in five shares of quite a few companies –Berskshire Hathaway being the most notable example – would be a material amount to many shareholders (such a position in Berkshire Hathaway would currently be worth about $850,000).

Such a definition sweeps within its purview basically all accounts managed by advisors at any firm. And, most importantly, it does so without regard to its supposed underlying purpose – namely that "almost all Managed Account investors delegate voting to the investment manager". In fact, depending on the platform, this statement is simply untrue. On the Folio platform, and in particular because we have worked hard to facilitate and encourage investors to participate in corporate governance matters, both self-directed retail and advised (or "managed" as defined here) investors retain the right to vote, and in most cases have not delegated that voting authority to anyone else. Even in those instances on our platform where investors have made an original delegation to another, our platform allows the investor to retain, if they wish, the right to receive the proxy materials and the final authority to overrule the investment manager and vote as the investor so desires.

Put simply and put another way – these investors, in holding their securities through "Managed Accounts", are in no different position than a self-directed retail investor with respect to their ability to vote on corporate governance matters such as annual proxy voting. And this is true regardless of there being an investment manager that has selected a portfolio of investments for them.

Instead of ignoring the premise on which the proposal is based – namely, that "almost all [Managed Account holders] delegated their voting rights" to an investment manager -- if the definition instead had simply been that a "Managed Account" for purposes of this proposed rule is "any account over which voting delegation has been fully passed to another", then there would have been a cognizable and justifiable rationale for the proposal. And were it to provide that in those circumstances distribution of materials (and hence payment for distribution) is not needed at all (except to the person with the delegated authority), this part of the proposal would have been supportable. But to disenfranchise all smaller shareholders in managed/advised accounts on the asserted general belief that almost all of them delegate voting authority is irrational, especially when the definition of "Managed Account" could be the trivially easy determination as to whether such shareholders have, in fact, made such delegation.

Similarly irrational is the notion of paying one rate ($0.32) for distribution of materials to a nominees' beneficial owners and a different, albeit lower rate ($0.16) to nominees whose beneficial owners with more than five shares are in managed accounts *and who have delegated* their voting rights to the manager. As noted below, this structure pays nominees for not distributing materials to beneficial owners who will not be voting their shares because they have delegated their voting rights to the manager. This payment is merely a "split the difference" approach that maintains at least part of a revenue stream from issuers to nominees, but for no good reason and for no reason cognizable under Regulation 14A.

2. **Disenfranchisement of All Fraction-of-a-Share Shareholders.** The proposed rule provides that no fee is to be incurred by any issuer for a nominee account that contains only a fractional share, whether managed or non-managed, thus effectively disenfranchising such shareholders. Under the law of many states – including notably, Delaware -- holders of fractional shares are not necessarily disenfranchised and are entitled to vote.[4] This abrogation of a bedrock shareholder right must be rejected as unlawful. If the proposed rule instead had stated that, where a fractional share of an issuer is, *in fact, not* entitled to vote, then no requirement would exist for distribution of such issuer's proxy materials and, obviously then, no payment would be required, then that would be a reasonable proposal consistent with Regulation 14A. But, once again, the proposed rule simply sweeps away smaller shareholders[5] seemingly on the grounds that they simply are unimportant and irrelevant, regardless of the fact that they may have voting rights. If the Commission determines that it is the correct public policy to engage in such sweeping disenfranchisements of smaller shareholders, it should seek a rule change to do so and solicit public comment on that point.

3. **Absence of Support for the Proposed Changes as "Reasonable Expenses" for Proxy Distribution.** The proposed rule changes in the fee schedules, as the Commission points out in its Release, also have no support from any reliable objective source. The third-party audit of proxy distribution costs that the Proxy Working Group recommended in 2006 has never been done. And as noted by the Commission, contrary to the views of some commenters, there is no basis to call the proposed fee structure "market-based" since one intermediary has a near-monopoly on the third-party proxy service provider market. Further evidence comes from the proposed fee that grants the "intermediary" -- basically one entity -- an extra fee that all others assuming the obligation to distribute proxy materials directly do not obtain.[6] The proposed rule changes merely represent an equilibrium of satisfaction among the dominant intermediary for some broker-dealers and some issuers represented in the process that produced the proposed rule changes, without regard to how they impact or

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[4] Section 155 of the Delaware Corporate Code provides in relevant part as follows:

> A certificate for a fractional share or an uncertificated fractional share shall, but scrip or warrants shall not unless otherwise provided therein, entitle the holder to exercise voting rights, to receive dividends thereon and to participate in any of the assets of the corporation in the event of liquidation.

[5] Of course, not all fractional shareholdings are small: half a share of Berkshire Hathaway, as of this writing, represents an investment of about $85,000 – a few times more than the average account size at E*Trade.

[6] See note 1, *supra*.

effect the shareholders that the rules are supposed to protect and serve. This is evident in the numerous references among the framers of the proposal, reflected in the Release, to how the proposed rule changes would affect the "revenue" of the dominant intermediary but with so little reference to the costs of performing the applicable services or to the impact on shareholders. The Commission therefore has no basis for assessing whether the proposed changes meet the legal standard of providing for the "reasonable expenses" of proxy distribution and would be acting arbitrarily and capriciously if it approved the proposed rule changes.

4. **Nominees (and Intermediaries) Should Not be Compensated for Not Distributing Proxy Materials to Beneficial Owners in Managed Accounts.** With respect to Managed Accounts, the proposed rule changes also have no adequate rationale in the converse circumstances where materials are not distributed. The proposed rule changes take as a given that in most cases, shareholders in Managed Accounts have delegated their voting rights to the manager of the account and thus have eliminated the need for the issuer to furnish proxy materials to each beneficial owner in the Managed Account.[7] Yet the proposed rules would, incongruously, continue to make a payment to all nominees based on beneficial owners (with share positions in excess of five) in Managed Accounts, each year every year –- where the distribution to beneficial owners has been eliminated by the nominee. The purported rationale for this "Preference Management Fee" is that there needs to be "data processing" from time to time to check whether a beneficial owner has changed his or her preference as to voting delegation – even though it is asserted that this rarely happens[8]. There is no indication whether this fee is at all related to the cost of the "data processing" claimed to be necessary, or whether it is a "reasonable expense". More to the point though, Regulation 14A clearly states that it compensates solely for distribution of materials – not for the non-distribution of materials.[9]

[7] We know that the expectation that such delegation almost always occurs is not true on the Folio platform where we have made the exercise of voting rights user-friendly, and have sought to facilitate shareholder involvement in governance activities. And to assume that today's alleged reality as to how many people have delegated voting will be tomorrow's reality is a poor assumption to base a rule on. The ever increasing computerization available to all custodians that allows them to empower all shareholders to easily maintain voting rights is as likely as not to shift the numbers again.

[8] For some reason, the proposal seems to assume no "data processing" is needed to determine the size of a holding in a Managed Account or whether an account is a Managed Account – as it simply pays nothing for five or fewer share positions in Managed Accounts.

[9] Some agreements for managed accounts provide for full delegation of voting rights to the manager as part of the services they provide. To the extent brokers know whether the managed accounts that they make available to customers contain these provisions, this proposed rule change appears difficult to justify. If the broker knows what the agreement says, periodic checking is not necessary,

5. **Unjustified "Incentive" Payments for Adoption of Enhanced Brokers' Internet Platform ("EBIP").** The proposed rule changes step boldly into the 21st Century with the idea that proxy distribution could be vastly simplified with broad adoption of electronic delivery through portals that investors would trust, such as a portal offered by the investor's own broker. Folio implemented such a portal for all of its customers when it commenced operations more than thirteen years ago -- and would be more than pleased to make it available to others as well.[10] The Release notes that the Commission discussed this trusted portal approach in its 2010 Proxy Concept Release, referring to it as EBIP, then adds the following:

> According to the Exchange, Broadridge discussed with the PFAC a similar service that it offers and maintained that while some brokerage firms have already implemented services like the EBIP, it appeared likely that some financial incentive would be necessary to achieve widespread adoption.[11]

On this basis, the Release notes, the Exchange has proposed an incentive fee to get brokers to do what some, including Folio, have already done. The brokers who already have instituted EBIPs, and persuaded their customers to adopt them because they were obviously a better offering with more reliable service for their customers who wished to exercise their voting rights, have already incurred substantial and significant costs. But these brokers will get nothing under this proposal for already having done the right thing.[12] The dominant

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nor is even an initial check necessary. For platforms and programs that allow an investor to select for themselves (as ours does) whether and to what extent to delegate voting rights, then the issue is simple: to whom is there a distribution of proxy materials? If the materials are distributed to the investor, then the full payment should be received, just as would be the case with a self-directed retail investor. If materials are not distributed to investors because they have fully delegated their voting rights to a manager, then compensation should be received solely to reimburse for the cost of the single distribution to the manager, but no other compensation is warranted. Nothing else is authorized under Regulation 14A.

[10] Folio recognizes that it would benefit from the Incentive payment for EBIPs in the context of its offering its competing technology to brokers. We, however, do not subscribe to the argument that asserts that this is a justifiable expense to be reimbursed under Regulation 14A. As a matter of policy, paying some to do what others who attempt to do good have already done provides a bonus to those who delayed or refused to act – that is not something to be encouraged.

[11] Release at 22.

[12] There appears to be a further quirk in the proposal that if a broker implements an EBIP but has customers not on it, that broker still gets a conversion payment because it will help market EBIP to non-converted customers. For those brokers, like Folio, that worked hard to have all customers

intermediary, who has already discussed its proprietary service with the PFAC, and those brokers who have resisted implementing an EBIP, will instead get the benefit of an issuer-paid marketing incentive. In light of the Commission's already-stated concern about the payment of excess-profit "rebates" of issuer-paid fees to certain broker-dealers, this proposal must be regarded as inequitable and unjustified.[13]

6. **Proper Forum for Rulemaking.** Finally, the proposed rule is intended to be enforced industry-wide, including with respect to non-NYSE members and issuers not listed on the NYSE – but it is proposed as an NYSE rule. If this is to be an industry-wide rule adopted pursuant to Regulation 14A, then the Commission itself should implement appropriate rule-making to such effect, including in compliance with the APA, the Sunshine Act and other applicable laws. Had that been done at the outset, the rulemaking might be ripe for true consideration. As a general policy matter, we believe strongly that the Commission should not delegate important matters to third parties that have vested interests in outcomes yet purport to be quasi-governmental regulators. The regulatory process suffers when there is an absence of Commission expertise, an absence of independent staff providing informed and unbiased recommendations and an absence of its Presidential nominated and Senate confirmed heads making final decisions of importance. It is that Commission staff expertise, independence, lack of bias, and Commission governmental leadership that allows the public to have faith in the Commission's rules and regulations, its policies and its procedures and its decisions and its actions. The Commission should reverse the admittedly long-standing practice of continual delegation to what perhaps were once self-regulatory bodies, but which are now organizations focused on their own needs and rewards.

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For the foregoing reasons, Folio respectfully urges the Commission to reject the proposed rule changes at issue in the Release.

Respectfully submitted,

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Michael J. Hogan
Chief Executive Officer
FOLIO*fn* Investments, Inc.

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using an EBIP and have already incurred all the costs of that internally without subsidy it is hard to see how this proposal is fair and equitable.

[13] Release at 55-56.