MEMORANDUM

To: File No. S7-10-05: Internet Availability of Proxy Materials (Proposed Rule)

From: Jonathan Block, Counsel to Commissioner Campos

Date: March 29, 2006

Re: Meeting with Representatives from Automatic Data Processing (ADP)

On March 14, 2006, Richard Daly, Bob Schifellite, Chuck Callan, Adam Amsterdam, and Maryellen Andersen of ADP, as well as David B.H. Martin and Keir Gumbs of Covington & Burling, met with Commissioner Campos and his legal counsel Jonathan Block and discussed their comment letter on this proposal as well as the attached material that they provided, entitled "Internet Availability of Proxy Materials: A Discussion of Street-Side Shareholder Communication and Proxy Voting."
Internet Availability of Proxy Materials

A Discussion of Street-Side Shareholder Communication and Proxy Voting

U.S. Securities and Exchange Commission
March 14, 2006
Street-Side Investor Communications and Proxy Voting
High-Level Overview

- Over 85%, and growing, of U.S. companies’ shares are held in street name. A diminishing percentage of shares is held in registered name with the issuer.

- Typically, institutional investors (pension funds, mutual funds, money managers, hedge funds) hold shares with custodian banks. Individual investors hold shares with brokers.

- Approximately 40% of street investors (owning 60% of the shares) object to being identified to the issuers whose shares they hold.

- The SEC requires issuers to provide proxy materials to record owners in sufficient quantity to permit dissemination of material to beneficial owners.

- The NYSE specifies that banks and brokers must forward issuer proxy materials to their clients/account holders and enable them to vote. The NYSE specifies fees for banks and brokers to be reimbursed by issuers.

Critics complain that the street process is complex and multi-layered. The street process is a result of U.S. equity clearing & settlement processes. It was not invented in isolation for proxy purposes alone.
Overview of the Street Proxy Voting Process

Sample of Functionality Not Found in Registered Shares Processing

“The following services, although not required, have been provided for beneficial processing under the existing fee structure. Registered processing, while not requiring all of these services, charges additional fees for services such as telephone voting, internet voting, electronic distribution, householding, etc:"

- Fiscal Year End Profile Distribution to 12,000+ Issuers
- Search Card Notification Processing
- Ad Hoc Request for Material Estimates
- Consolidated Search and Proxy Record Date
- Shareowner Positions Material Requirements Request to Nominee/Clients (across 800 nominees)
- Provide Nominee/Client with Report Confirming Total Positions and Shares Transmitted for Each CUSIP (across 800 nominees)
- Rule All Proposals (Based on NYSE)
- Assignment of Proposal Code
- Addition and/or Deletion of Record Date Beneficial Owner Name and Address Information
- Vote Reporting by Nominees
  - 15/10 Days; 9 Days Before Meeting Through Day of Meeting
  - 2 Vote Reports Day Before Meeting
  - Day of Meeting Votes
- Electronic Voting Transmission to Solicitor and Transfer Agent
- Vote Inquiries (Banks, Brokers and Institutions Not Voted)
- Consolidated Voting Across Nominees
- Confidentiality of Client Beneficial Shareowner Data
- Exception Processing
- Co-Trustee Processing
- Internet and Telephone Votes for 12,000+ Issuers
- Internet distribution for 12,000+ Issuers
- DTC Over Vote Monitoring
- Vote Confirmation Reporting
- Advanced Record Date Notification
- Meetings with Dissenters Rights Reporting
- Non-Mailed Accounts as of First Issued Vote Reporting
- Closed Meeting Report
- Bank, Broker Confirmation of Mailing
- Bank, Broker Vote Confirmation Summary
- Disaster Recovery
- Interactive Voice Response System
- Affidavit of Compliance (Self-Reporting Mechanism Between ADP and Its Clients as Required by NYSE)
- Annual Procedural Audit Report as Required by NYSE
- Weekly Measurement Criteria
- Vote Statistical Audit
- ISO 9002 Certification
- Consolidated Invoicing (Across 800 Nominees)
- Building and Maintenance of Householding Database (Across 800 Nominees)
- Building and Maintenance of Email Database (Across 800 Nominees)
- Funding of Postage Expense on Behalf of Issuer
- Bank/Broker Expense
- Maintenance of Records for 3 Years

Source: Proxy Voting Review Committee, 2002. Today, over 40% of ADP street accounts require specialized processing. And, there are approximately 100 million investor 'consents' to householding and e-delivery.
ADP's Role in Shareholder Communications and Proxy Voting
Plumbing and Investments

- **Scope:**
  - 87 million investors
  - 12,000+ U.S. meetings
  - 800+ banks and brokers
  - Over 80% of all outstanding shares

- **Economies of scale:**
  - A uniform, accurate process for: identifying street investors, capturing investor preferences and consents, estimating materials requirements, shipping to one location, providing bulk mail discounts, consolidating the invoicing, and reporting meeting status

- **Technology and critical industry solutions – examples:**
  - Specialized processing and voting logic, over 40% of all street accounts
  - Preference processing for eliminating mailings at investor's direction, e.g., householding and e-delivery; Open Enrollment
  - 24x7 voting technologies for all public companies
  - ICSonline – vote status and meeting management tools
  - Over Reporting Prevention Service

- **Services for institutional investors and fund managers – examples:**
  - ProxyEdge: over 2,500 institutions and 55% of all street shares. Consistent presentation across issuers, workflow, and compliance
  - ProxyDisclosure: vote reporting for mutual funds

- **ADP is also a servicing agent to 500+- corporate issuers for registered share owner communications and proxy voting.**

*Note: ADP does not provide research and advisory services. ADP does not have an interest in the outcome of shareholder proposals. ADP is an arms-length processing services provider for nominees.*
Proxy Season Statistics: Ten-Year Trend
Increasing Levels of Participation

**Proxy "Season" (2/15-5/1)**

### Increasing Volume

Total shares processed by ADP (Billions)

- '96: 91
- '97: 104
- '98: 156
- '99: 188
- '00: 210
- '01: 231
- '02: 247
- '03: 237
- '04: 261
- '05: 300

### Increasing Participation

Of the shares processed by ADP, the percent that were voted

- '96: 84%
- '97: 85%
- '98: 86.2%
- '99: 87.6%
- '00: 87.9%
- '01: 88.2%
- '02: 88.9%
- '03: 90.4%
- '04: 90.7%
- '05: 87.7%
Proxy Season Statistics Ten-Year Trends: Increasing Efficiencies for Corporate Issuers

Of the Shares Voted through ADP, the Percent that Were Voted Electronically

Electronic Voting Includes Telephone, Internet and ProxyEdge. Broker Votes are Excluded.

Mailings Eliminated at the Direction of Investors (as a % All ADP Accounts Processed)*

Eliminations Include ProxyEdge, Managed Accounts, Consents to E-Delivery and Household (as of 12/00)

* Note: savings as a percent of all mailed pieces were 19.2% ('01), 31.1% ('02), 40.3% ('03), 51.4% ('04), and 63.5% ('05).
Hewlett Packard/Compaq Review

Mailings
Number of mailings: Management (8), Opposition (6). Total pieces net of suppressions: 8,578,877 pieces
Turnaround time: all mailings completed in under 2 business days.

Tabulation/Updates
Void Reports to 335 clients. Contest Status Reports representing 575 nominees
26 full-time Client Service Associates supported the process

Audit and Review
Vote Audit teams spent 7,000 hours, including around-the-clock coverage

Vote Return Highlights
Processed 1.4 million returns, representing 2.3 billion shares
Voted 550,000 accounts, processed 440,000 changes in votes, representing 342 million shares.
Resolved 68,000 ‘void votes,’ representing 63 million shares

After having received, processed and audited all votes for street shares (94%), ADP issued its final vote in conjunction with the closing of the polls. It was not changed by the Inspector of Elections. In contrast, the 6% of votes from registered shares (not processed by ADP) took 7 weeks to be counted and finalized.
ADP Technology in Perspective

- Over 8,000,000 lines of code, adding or revising 750,000 lines each year
- Over 350,000 un-weighted function points, adding and/or revising over 30% annually
- Approximately 400 man years of program development invested in unique functions
- ICS Development Shop is CMM Level 2 with 3 of the 7 KPA’s for Level 3 in place
- Single day peak processing: over 500,000 separate client (nominee) votes across more than 2500 issuers
- World-class brokerage datacenter; over $300 million invested
- Advanced practices for information security and disaster recovery
  - 2-hour recovery from point of failure
  - Redundant communications networks, can switch if a major carrier goes down.
  - IBM Sterling Forest facility, and full back up
  - Appropriate levels of security: physical and information
  - Annual review of disaster recovery plans and testing with the SEC (3/1/06)
- Industry tools for electronic distribution and electronic voting
- Specialized processing for over 40% of all accounts processed
Research on Notice and Access
Potential for Unintended Consequences

Research

Investor Demographics and Online Usage

Telephone Survey of 1,500 Investors

Online Survey of 1,700 Frequent Internet Users

White Papers on “Defaults,” and Opt-In/Opt-Out Behavior

Costs-Benefits Analysis - Lexecon, Inc.

Potential Outcomes

Less looking and voting

Less ‘informed voting’

Higher costs for some investors and issuers

Other repercussions, e.g., the “Broker Vote,” lose investors before converting to XBRL

With the exception of AARP, no other commenter provided market research on the potential impact on investor participation and costs.
## Notice and Access Summary
### Enhancing Participation and Reducing Costs

<table>
<thead>
<tr>
<th>SEC Assumptions and Objectives</th>
<th>Research Findings</th>
<th>Characteristics of Dual Distribution Alternative</th>
</tr>
</thead>
<tbody>
<tr>
<td>75% have Internet access at home; growing % all ages</td>
<td>Millions not online; millions more no broadband at home; demographic impact</td>
<td>All investors continue to automatically receive information, as they have elected</td>
</tr>
<tr>
<td>Enhanced participation – knowledge and voting</td>
<td>High levels of looking and voting today; lower levels of ‘informed voting’</td>
<td>No decrease in participation; greater opportunity to adopt e-delivery</td>
</tr>
<tr>
<td>‘Investors are unaware of e-delivery’</td>
<td>72% are aware today</td>
<td>Greater awareness; supported by intermediaries</td>
</tr>
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<td>‘Investors are not unwilling to receive information electronically’</td>
<td>Strong preferences for printed material by mail</td>
<td>Keeps investors participating while converting to XBRL</td>
</tr>
<tr>
<td>Lower costs</td>
<td>Range of estimates: ($181)m to + $205 m. The lower the participation, the greater the economic benefit.</td>
<td>Higher e-participation without negative consequences; each 10 percentage point increase in participation would result in an additional savings of over $150 million using estimates of total cost per mailed proxy.</td>
</tr>
</tbody>
</table>
US Investor Households
Potential Impact on Investor Segments

<table>
<thead>
<tr>
<th>Investor Segments</th>
<th>10 million</th>
<th>4 million</th>
<th>6.3 million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seniors (60+)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Annual Income under $50,000</td>
<td>14.2 million</td>
<td>8 million</td>
<td>11 million</td>
</tr>
<tr>
<td>Rural and Smaller Market</td>
<td>10.5 million</td>
<td>2.5 million</td>
<td>8.1 million</td>
</tr>
<tr>
<td>African American</td>
<td>2.8 million</td>
<td>700 thousand</td>
<td>2 million</td>
</tr>
</tbody>
</table>

Just 38% of all investor households have broadband at home.

Source: Forrester’s Consumer Technographics® Q3 2005 North American Benchmark Survey – base of 42 million investor households. Multiple investors under one roof are counted as one ‘investor household.’
Telephone Survey Results

Investors indicate the Notice and Access rule would make them *less likely* to look at corporate disclosures and *less likely* to vote their proxies.

<table>
<thead>
<tr>
<th></th>
<th>38%</th>
<th>16%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Look at Disclosures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cast Votes</td>
<td>38%</td>
<td>12%</td>
</tr>
</tbody>
</table>

*Source: Telephone Survey of 1,500 investors, conducted by Forrester Research, January 2 – January 10, 2006.*

*Note: Similar indications from AARP’s survey of investors 25+ yrs old – 39% indicate they would be less likely to read, 14% more likely to read; 33% less likely to vote, 15% more likely to vote.*
Lower Levels of *Informed Voting*

Voters indicate that including a ballot with the notice will make them more likely to vote *without* looking at the annual report and proxy voting information.

**Under the Current Rule**

95% of voters indicate they look at the information “all,” “most,” or “some” of the time.

**With the Proposed Rule**

54% say they will vote *without looking* at the information “all,” “most,” or “some” of the time.

*Source:* Telephone Survey of 1,500 investors, conducted by Forrester Research, January 2 – January 10, 2006.
Many Investors Are *Unlikely* to Take the Required Steps.

Q13. (If Online and Mail Receivers) Under the proposed new rule, you will have to take new or additional steps to get your annual reports and proxy voting information. Please state if you are likely or unlikely to do the following (select one answer for each row):

- Go to the companies' Web sites and look at the information online: Likely 51%, Unlikely 49%
- Email a request for information to be sent to you: Likely 36%, Unlikely 64%
- Call the toll-free number to request the information to be sent to you: Likely 35%, Unlikely 65%
- Download and print out the information from the Internet: Likely 25%, Unlikely 75%
- Do nothing: Likely 42%, Unlikely 58%

Base: 971 Online mail receivers
Core Assumption of Proposed Rule
‘Investors are unaware of e-delivery, but not unwilling.’

Not Supported by Facts:
- Majority of issuers offer e-delivery today
- 3 billion notifications inviting investors to enroll in e-delivery
  - Approximately 13 million, and growing, have consented to e-delivery.
  - Over 2.4 million of them rescinded their consent.
  - Exit interviews with over 85,000: prefer to receive this information in print, problems/issues with online usage
- 36% of Internet votes come from investors who receive printed materials.
  - Offered InvestorDelivery.com
- Open Enrollment programs at issuers and brokerage firms

Not Supported by Research:
- Forrester Telephone Survey: 72% of ‘mail receivers’ say they are aware e-delivery is an option.
- comScore Online Survey: 71.7% of ‘mail receivers’ are aware e-delivery is an option.
- AARP Survey (includes stock and mutual fund investors, 84% of whom have Internet access) – preferred method:
  - 64% regular mail
  - 14% email with link to website
  - 11% mailed letter with website address
  - 9% email with attachments
Research on Changing “Defaults”

- Studies on Opt-In and Opt-Out programs were identified and summarized by two behavioral economists:
  - Sendhil Mullainathan, a MacArthur Fellow, Harvard University
  - Eric Johnson, Columbia University
  - 401(k) participation, rebate offers and redemptions, and other studies

- Small changes in defaults can have a major impact on behavior.
  - Opt-in rates are low. Opt-out rates are low.
  - When there is a change in the status quo, people frequently take no action.

- Requiring investors to take steps is not the same as automatically sending information.
  - Would likely result in less reading and voting

- Need for well-designed pilots
  - High degree of confidence that questions of participation and preference can be addressed in advance
Costs-Benefits Analysis
The Proposed Rule Could End Up Costing More

Proposed Rule:
- Fixed costs remain, some new costs added
- Some costs shifted to investors
- More expensive fulfillment model: Today: "Pick 'N Pack" per unit cost = 6x "Mass Fulfillment"

Lexecon, Inc.
- Cost impact on issuers and investors
- Depends on investor participation
- Overall cost-benefit for public companies (2005): (-)$180 m to +$205 m

'‘The proposed rule leads to cost savings precisely when enough shareholders are discouraged from requesting materials.’

Note: Concerns about higher costs to small- mid-cap issuers – refer to comment letter of the American Business Conference
Alternatives
Greater Efficiencies Without Compromising Participation

- **Dual Distribution to Broker e-Mail Addresses:**
  - E-Mail message with Internet voting to every individual investor – two criteria:
    - Currently receive printed information by mail
    - Email address on file with broker-dealer – potential to increase suppression rate to 60+% (from 45% (e) in 2006).
  - Electronic distribution – encouraging e-delivery, explaining the benefits, click-through to consent capture
    - Broker-dealer customer education and support
    - ADP and broker-dealer technology solutions
  - Potential savings: Increase in physical delivery suppression rate to 60-70%. Additional savings for issuers.

- **Smaller, less-expensive, compliance document:**
  - Example Bed, Bath and Beyond
    - $0.82 total per unit cost vs. over $5.00 for glossy
  - Potential savings for issuers: hundreds of millions of dollars

- **XBRL for proxy**
  - Potential to add value to Internet experience
  - Dependent on progress with financial reporting
  - ADP commitment to invest
Proposed Rule and Alternatives: Well-Designed Pilots
Unbiased Estimation of Participation and Savings

**Designs acceptable to the SEC – to be discussed:**

- Representative samples of investors – impact on demographic groups
- Random assignment - to compare control and treatment groups
- Vary conditions at the:
  - Investment level
  - Investor level
  - Information level
  - Offer level
- Automated information capture
- Post-pilot telephone survey
- Measure participation rates in access methods, investor knowledge, process satisfaction, intentions to switch, and behavior over time