

WHITE PAPER

# Comment letters on proxy reform show strong support for change

THE **STA**  
SECURITIES TRANSFER  
ASSOCIATION, INC.

## EXECUTIVE SUMMARY

On July 14, 2010, the SEC issued a concept release seeking comment from the public on potential reforms to the U.S. proxy system. It has been 30 years since the SEC has considered a comprehensive review of proxy mechanics. The public had a 90-day window to submit comments to the Commission, which closed on October 20. Roughly 200 original letters came in as of November 1, 63 of which came from issuers, and The Securities Transfer Association conducted an analysis of each letter to determine the sentiment on a number of important issues raised in the concept release.

Among the key findings:

*For issuers:*

- More than 98 percent of issuers support reforming/eliminating NOBO/OBO; 77 percent of all respondents supported reform/elimination
- Of the 42 issuers expressing an opinion, all agreed that regulations should be changed to create fair market competition for proxy distribution and communication services; 88 percent of all respondents supported open competition

*For all respondents:*

- Of the respondents expressing an opinion on client directed voting (CDV), only one out of 64 did not support implementing CDV as a policy
- Of the respondents expressing an opinion on over-voting and under-voting, 92 percent supported reforms to prevent future incidents of over-voting and under-voting
- Of the respondents expressing an opinion on regulated fees, more than 87 percent stated that current regulated fees do not accurately reflect the costs of beneficial owner data aggregation

## BACKGROUND

Since the SEC issued its concept release on the mechanics of the U.S. proxy system on July 14, it has been noted by almost everyone involved in the process – regulators, issuers, investors,<sup>1</sup> service providers, academics and industry

organizations – that this comprehensive review is a major undertaking. There is no doubt that this top-to-bottom review represents a major commitment by the SEC to examine the marketplace of 2010 – and its future needs – and determine if fundamental changes are required to improve the voting process and issuer-shareholder engagement.

The concept release itself is 151 pages long and poses dozens of questions in which the SEC seeks input from the public. The SEC received 199 original letters during the comment period, plus several thousand copies of a form letter.<sup>2</sup> To gain a better understanding of the relevant issues, The Securities Transfer Association conducted a thorough analysis of the content of the letters to determine the sentiment among those who offered comments.

We categorized the letters by respondent (issuer, broker, investor, etc.) and further broke down the responses by the major areas in which the SEC sought comment (vote confirmation, NOBO/OBO, etc.). Based on the suggestions and recommendations contained in the letter, we set a value for each major topic area: very supportive, supportive, no position, negative, very negative.

Looking at the big picture, the responses appear to indicate a clear desire among the issuer and shareholder communities to reform the system in a way that delivers a higher degree of integrity, open competition and lower costs. In fact, of the 199 original letters submitted, only two expressed a “very negative” opinion on proposed reforms to any of the issues: the American Business Conference, and Broadridge (which stands to gain the most by maintaining the status quo). The implication is clear: the consensus among all stakeholders – from issuers to academics – is that major reforms are badly needed.

Below are a number of highlights pulled from the analysis of the comment letters conducted by The Securities Transfer Association which further emphasizes the desire for reform.

## NOBO/OBO CLASSIFICATIONS

In section IV A of the concept release, the SEC sought comment on the NOBO/OBO classification system. Established in the mid-1980s, the NOBO/OBO classifications have allowed street-name holders to remain anonymous to the issuers in which they invest. At the time NOBO/OBO was established, street-name shareholders represented about 25 percent of the marketplace, with registered holders accounting for about 75 percent. In the ensuing years, that figure has flipped. As Jeffrey Morgan, CEO of the National Investor Relations Institute, noted in his organization’s comment letter, “The NOBO/OBO distinction appears rooted in history rather than necessity or investor preference.”

In its August 4, 2009 letter to the SEC, the Shareholder Communications Coalition (“Coalition”) called for the elimination of the outdated NOBO/OBO system to allow issuers direct engagement with their shareholders. Those who still wish to remain anonymous would be able to do so through a nominee or custodial account.

In examining the letters submitted to the SEC, there is overwhelming support for the Coalition’s position. Of the 128 respondents expressing an opinion on NOBO/OBO, 99 endorsed the reformation or elimination of the classifications, a total of 77.4 percent. Nearly 80 percent of individual investors who commented to the SEC on the category of shareholder communication are supportive of more direct communications and the elimination of NOBO/OBO.

<sup>1</sup> While 24 individual investors responded to the concept release, nearly all of their letters spoke in generalities about support or opposition to the reform process, rather than addressing the technical details of the release. The letters from these 24 investors were considered for the overall analysis, but due to the small number of responses, individual investors are not analyzed across all categories as a separate group in this report.

<sup>2</sup> These form letters all come from a single write-in campaign and spoke in generalities about regulation rather than offering any comment on specific issues. Therefore, they were disregarded for this analysis. However, they gave guidance about how the commission might go about addressing reform.

## COMPETITION AND CHOICE

In the existing structure, beneficial shareholder data aggregation and proxy distribution are dominated by a single provider, Broadridge, which controls more than 98 percent of the market for these services. While the fees for beneficial proxy communications are regulated, those fees are set arbitrarily (see below) and Broadridge employs policies that make it costly to obtain shareholder information – for example, requiring an issuer to purchase an entire beneficial owner list as opposed to, say, the top 5 percent of owners.

Furthermore, the issuers themselves have no say in the fees or contracts established with Broadridge for proxy communication and distribution. Contracts are created between Broadridge and broker-dealers, who then pass the invoice along to the issuer. The words “excessive” and “exorbitant” are common occurrences in letters from issuers when describing the costs associated with obtaining lists of beneficial owners. A study we released in October estimated a cost savings for issuers between 20 percent and 71 percent if proxy distribution and communications were subject to competitive forces.

In their comment letters, many issuers appeared to acknowledge that a near-monopoly operates at the heart of the U.S. proxy system. Of those issuers choosing to express an opinion on the issue, 100 percent agreed that the market for proxy distribution and communication services needs to be opened up to fair-market competition. Those 42 issuers represent two-thirds of all issuer respondents to the concept release. The remaining 21 offered no opinion on competition/choice in the comment letter.

We believe that the comments show that the response from the issuer community is clear: it’s time to introduce competition to the market for these services. That opinion is also reflected in the responses

outside of the issuer community. Of the original letters that express an opinion on competition and choice, 88 percent (75 out of 85) agreed that regulations should be reformed to allow for competition and choice for proxy distribution and communications.

## REGULATED FEES

It was 2002 when the NYSE last conducted a review of the regulated fee schedule for beneficial proxy communications. While there have been discussions of late regarding the NYSE reviewing and possibly revising the fee schedule, an adjustment to the fees alone, in our view, does not address the underlying problem. The NYSE even stated in its own comment letter that it no longer wishes to be responsible for establishing the fees and prefers a market-based solution.

As noted by the SEC in its concept release, it is common practice for Broadridge to routinely charge the maximum allowable regulated fee, leading the SEC to note, “This practice raises the question as to whether the fees in the NYSE schedule currently reflect ‘reasonable reimbursement.’”

As communication technologies continue to advance, it is, in our view, critical to develop a system that allows issuers to choose service providers based on price and innovation. By ending the practice of regulated fees, broker-agent contracts, and by creating a not-for-profit industry hub to aggregate beneficial shareholder data, the need for regulated fees should vanish, as competition principles could lead to lower costs and improved services.

Of the original letters that addressed the issue of regulated beneficial shareholder data fees, more than 87 percent (74 out of 85) believe that the current system of regulated fees does not accurately reflect the costs of compiling beneficial owner data.

Consistent with the principles set forth by the Coalition, the best solution, in our view, to the problem of excessively high regulated fees is to create a framework to allow these rates to be set by competitive forces – an opinion shared by the organization, the NYSE, currently charged with setting the rates.

## CLIENT DIRECTED VOTING

Client directed voting emerged as a significant issue to many respondents, with nearly a third of all comment letters offering an opinion on it. Of the 64 letters that addressed client direct voting, only one voiced opposition to adopting it. It is important to note that it can easily be incorporated into the regulatory changes we support. The Securities Transfer Association believes that competition and client directed voting are not mutually exclusive ideas.

## OVER-VOTING AND UNDER-VOTING

There have been a number of high-profile cases in recent years of proxy votes being marred by under-voting or over-voting (such as the case of Yahoo’s director vote in 2008). Many issuers have expressed opinions that over-voting and under-voting are major areas of concern, including United Health, which noted in its comment letter that it “routinely suffers major occurrences of attempted over-voting and under-voting.”

The responses to the concept release further bolster the concerns about tainted vote results due to over-voting and under-voting. Of those responses offering an opinion, 92 percent (68 out of 74) stated that reforms are necessary to prevent future cases of attempted over-voting and of under-voting.

## DATA TAGGING

While not as prominent in the minds of respondents as other core reform issues such as NOBO/OBO and pricing, data tagging may emerge as a necessary feature as the markets continue to adapt to modern technology. The results from the comment letters show that issuers and institutional investors are split on the need for data tagging of proxy materials, with all eight issuers who commented on the topic opposing it, and six of the seven institutional investors supporting it.

Of all respondents offering an opinion on data tagging, 61 percent of them (23 out of 38) supported data tagging of proxy related materials.

It seems clear that issuers are yet to be convinced of the need to implement such a system. Further consideration needs to be given to this matter through dialogue between operational experts for the key stakeholders.

## MOST IMPORTANT ISSUES TO INDUSTRY GROUPS AND ISSUERS

The SEC posed dozens of questions to the public in its concept release. There was no obligation to answer every question raised in the release, so examining the number of responses in each category paints a good picture of the issues at the top of mind of the public.

For both issuers and industry organizations who responded to the concept release, the three most important issues based on responses that expressed an opinion were: competition/choice, regulated fees and the NOBO/OBO classifications.

In each of those three areas, more than 60 percent of respondents from both communities offered opinions – with NOBO/OBO opinions greater than 80 percent for both issuers and institutions.

## OTHER POINTS OF NOTE IN THE COMMENT LETTERS

### *Lack of response from brokers and banks*

Brokers-dealers play a major role in the existing proxy system. As the holders of street-name account information, they are the root source for beneficial holder data. Through Broadridge, they provide issuers with the lists of shareholders for proxy distribution and communications. Given the prominence of banks and brokers in the discussion, it's interesting to note that only one broker-dealer (Morgan Stanley Smith Barney) chose to submit a comment letter.

### *Support from the academic community*

The SEC received 15 responses from the academic community. The concerns coming from universities appeared to echo those of the industry commenters. The issues which received the most response from academics are competition/choice, NOBO/OBO and regulated fees. Interestingly, every opinion expressed on those issues offered support for reforms similar to those of the Coalition.

### *Minimal opposition to reform*

As noted in the introduction, only two organizations submitted comments that were categorized as “very negative” – Broadridge and the American Business Conference. Based on our review of the comment letters, there would appear to be a lack of other opposition to reform in any of the areas discussed in the concept release, which, we believe, clearly indicates that there is a desire for reform to the U.S. proxy system among the affected players.

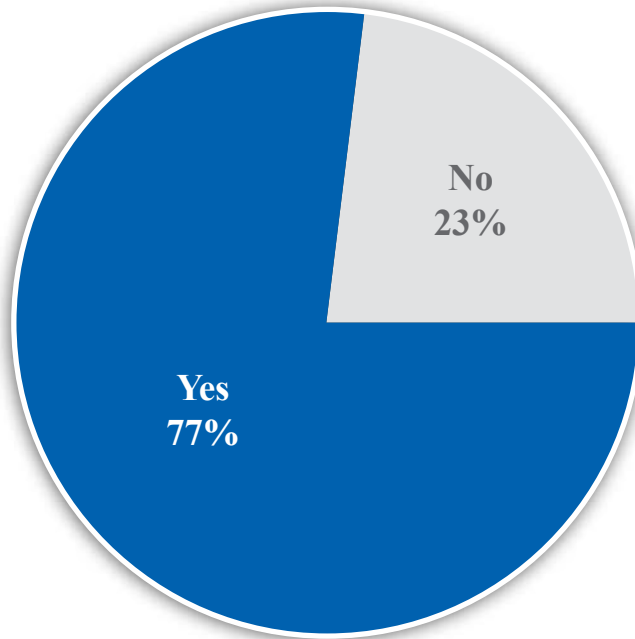
## CONCLUSION

It's been 30 years since the SEC examined the underlying mechanics of the proxy system. By asking for comment and suggestions on potential improvements, the SEC should be applauded for conducting this thorough review and moving to progressively implement change. In the three months since the SEC issued its concept release, 199 original letters (along with several thousand copies of a brief form letter) offered opinions on all matters contained in the release. The analysis of those letters is clear: The investing community desires change. The numbers speak for themselves – on the important issues affecting shareholder engagement and competition/choice, overwhelming majorities of those with opinions seek reform.

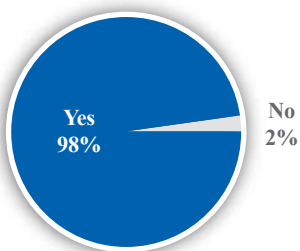
For more information about reforming the proxy system, visit [www.ReformTheProxySystem.com](http://www.ReformTheProxySystem.com).

**Chart 1: Favorability of those with an opinion on reforming NOBO/OBO to increase transparency of ownership**

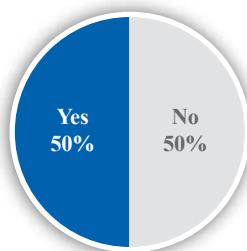
**All responses**



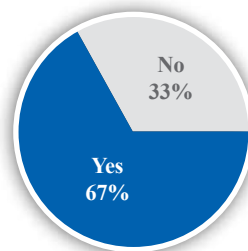
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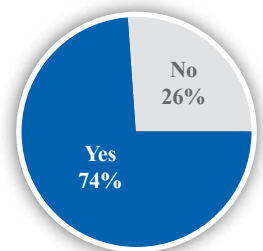
**Institutional investors**



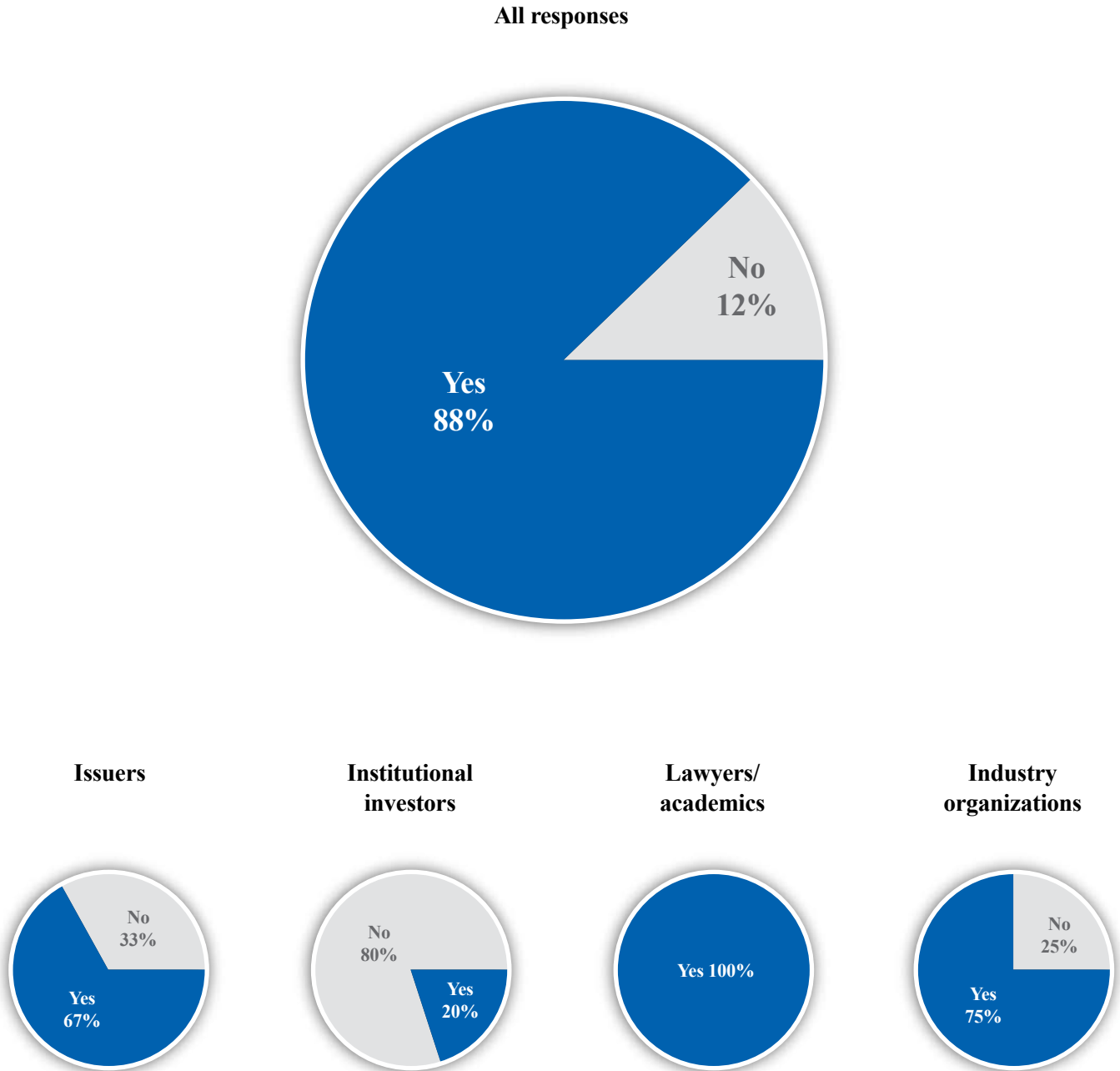
**Lawyers/ academics**



**Industry organizations**

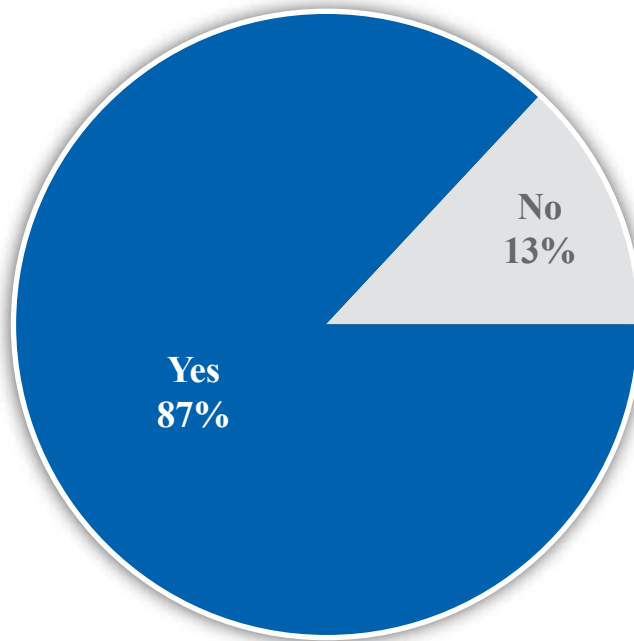


**Chart 2: Favorability of those with an opinion on reforming regulations to promote competition and choice among proxy distribution and communications services.**

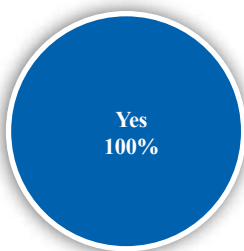


**Chart 3: Favorability of those with an opinion on reforming or eliminating the regulated fee structure.**

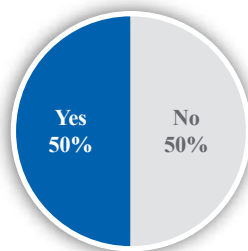
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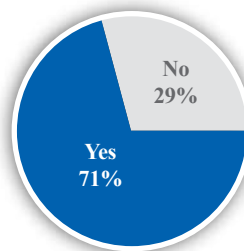
**Issuers**



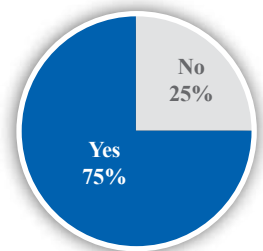
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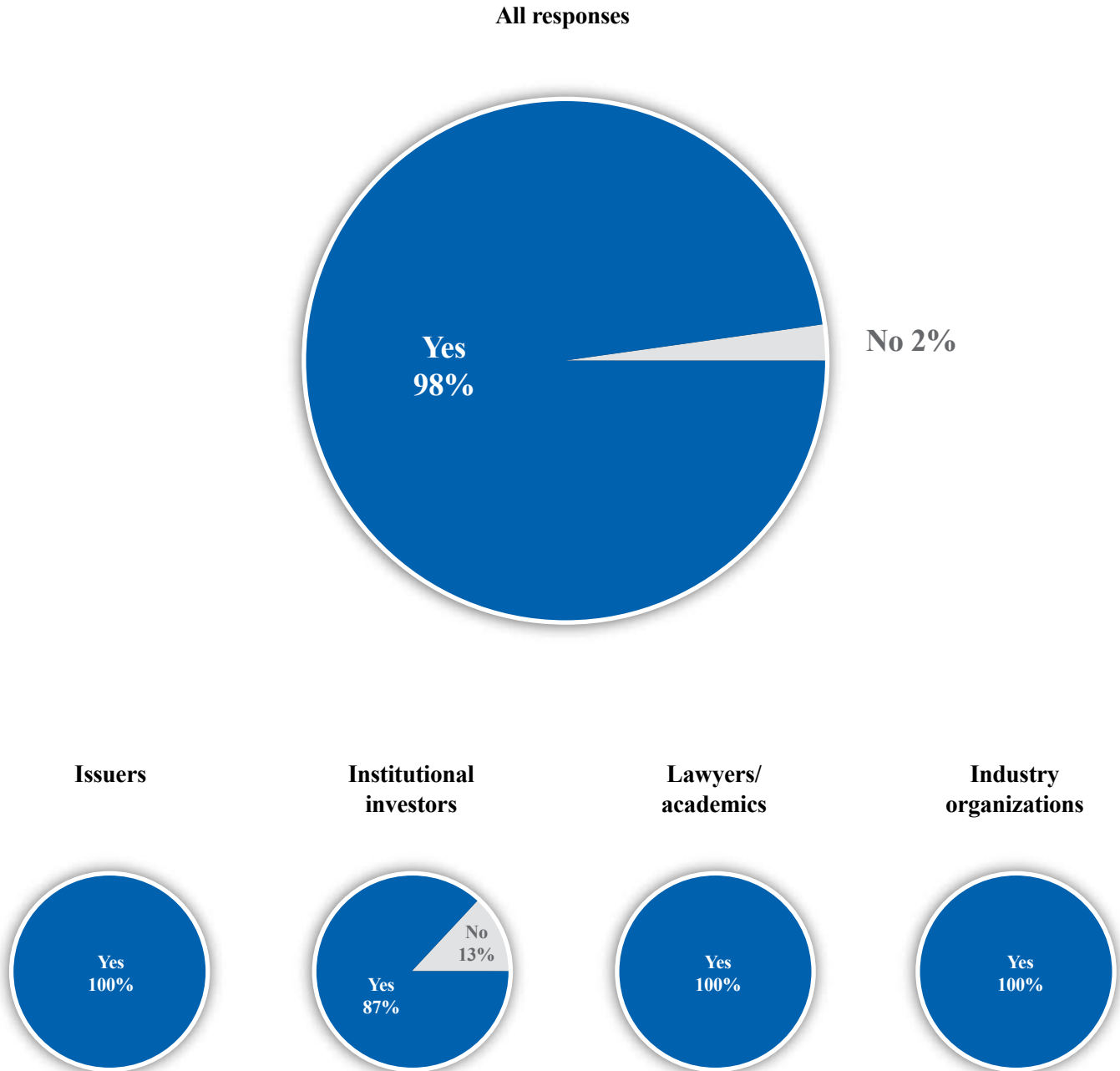
**Lawyers/ academics**



**Industry organizations**



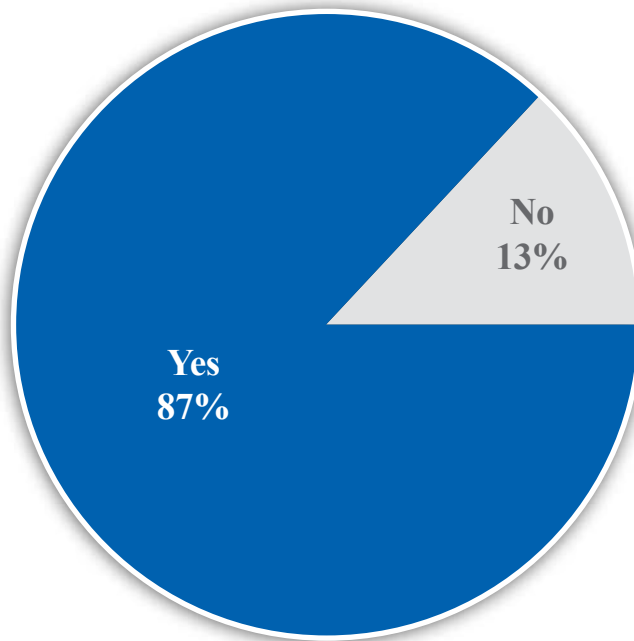
**Chart 4: Favorability of those with an opinion on implementing client directed voting.**



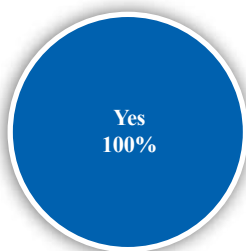


**Chart 5: Favorability of those with an opinion on implementing reforms to prevent over-voting and under-voting.**

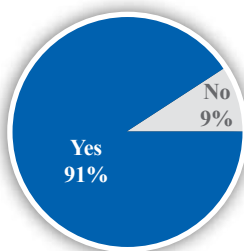
**All responses**



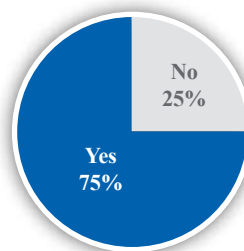
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