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17 CFR Parts 240, 270, 274, et al.
Concept Release on the U.S. Proxy System; Proposed Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240, 270, 274, and 275

[Release Nos. 34–62495; IA–3052; IC–29340; File No. S7–14–10]

RIN 3235–AK43

Concept Release on the U.S. Proxy System

AGENCY: Securities and Exchange Commission.

ACTION: Concept release; request for comments.

SUMMARY: The Commission is publishing this concept release to solicit comment on various aspects of the U.S. proxy system. It has been many years since we conducted a broad review of the system, and we are aware of industry and investor interest in the Commission's consideration of an update to its rules to promote greater efficiency and transparency in the system and enhance the accuracy and integrity of the shareholder vote. Therefore, we seek comment on the proxy system in general, including the various issues raised in this release involving the U.S. proxy system and certain related matters.

DATES: Comments should be received on or before October 20, 2010.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/concept.shtml*);
- Send an e-mail to *rule-comments@sec.gov*. Please include File Number S7–14–10 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549–1090.

All submissions should refer to File Number S7–14–10. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/concept.shtml*). Comments are also available for Web site viewing and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Raymond A. Be or Lawrence A. Hamermesh, Division of Corporation Finance, at (202) 551–3500, Susan M. Petersen or Andrew Madar, Division of Trading & Markets, at (202) 551–5777, Holly L. Hunter-Ceci or Brian P. Murphy, Division of Investment Management, at (202) 551–6825, or Joshua White, Division of Risk, Strategy, and Financial Innovation, at (202) 551–6655, 100 F Street, NE., Washington, DC 20549.

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I. Introduction

Regulation of the proxy solicitation process is one of the original responsibilities that Congress assigned to the Commission in 1934. The Commission has actively monitored the proxy process since receiving this

authority and has considered changes when it appeared that the process was not functioning in a manner that adequately protected the interests of investors.[1] In recent years, a number of our proxy-related rulemakings have been spurred by the Internet and other technological advances that enable more efficient communications. For example, we have adopted the "notice and access" model for the delivery of proxy materials,[2] as well as rules to facilitate the use of electronic shareholder forums.[3] Perceived deficiencies in the proxy distribution process have prompted other proxy-related rulemakings, such as rules to reinforce the obligation of issuers to distribute proxy materials to banks and brokers on a timely basis [4] and to permit the "householding" of proxy materials.[5] We have also periodically revised our rules requiring certain types of disclosures in the proxy statement, such as information on executive compensation and corporate governance matters.[6] We also have pending a proposal to adopt rules that would require, under certain circumstances, a company to include in its proxy materials a shareholder's, or group of shareholders', nominees for director.[7]

During many of these previous proxy-related rulemakings, commentators raised concerns about the proxy system as a whole.[8] In addition, the Commission's staff often receives complaints from individual investors about the administration of the proxy system.[9] We believe that these concerns and complaints merit attention because they address a subject of considerable importance—the corporate proxy—which, given the wide dispersion of shareholders, is the principal means by which shareholders can exercise their voting rights.

Accordingly, in this release, we are reviewing and seeking public comment as to whether the U.S. proxy system as a whole operates with the accuracy, reliability, transparency, accountability, and integrity that shareholders and issuers should rightfully expect. With over 600 billion shares voted every year at more than 13,000 shareholder meetings,[10] shareholders should be served by a well-functioning proxy system that promotes efficient and accurate voting. Moreover, recent developments, such as the revisions to Rule 452 of the New York Stock Exchange ("NYSE") limiting the ability of brokers to vote uninstructed shares in uncontested director elections [11] and other corporate governance trends such as increased adoption of a majority voting standard for the election of directors [12] have highlighted the importance of accuracy and accountability in the voting process.

The manner in which proxy materials are distributed and votes are processed and recorded involves a level of complexity not generally understood by those not involved in the process. This complexity stems, in large part, from the nature of share ownership in the United States, in which the vast majority of shares are held through securities intermediaries such as broker-dealers or banks; this structure supports prompt and accurate clearance and settlement of securities transactions, yet adds significant complexity to the proxy voting process.[13] As a result, the proxy system involves a wide array of third-party participants in addition to companies and their shareholders, including brokers, banks, custodians, securities depositories, transfer agents, proxy solicitors, proxy service providers, proxy advisory firms, and vote tabulators.[14] The use of some of these third parties improves efficiencies in processing and distributing proxy materials to shareholders, while at the same time the increased reliance on these third parties—some of which are not directly regulated by federal or state securities regulators—adds complexity to the proxy system and makes it less

[1] For a history of the Commission's efforts to regulate the proxy process since 1934, *see* Jill E. Fisch, *From Legitimacy to Logic: Reconstructing Proxy Regulation,* 46 Vand. L. Rev. 1129 (Oct. 1993).

[2] 17 CFR 240.14a–16; Shareholder Choice Regarding Proxy Materials, Release No. 34–56135 (July 26, 2007) [72 FR 42222] ("Notice and Access Release"); Amendments to Rules Requiring Internet Availability of Proxy Materials, Release No. 33–9108 (Feb. 22, 2010) [75 FR 9074].

[3] 17 CFR 240.14a–17; Electronic Shareholder Forums, Release No. 34–57172 (Jan. 18, 2008) [73 FR 4450]. These amendments clarified that participation in an electronic shareholder forum that could potentially constitute a solicitation subject to the proxy rules is exempt from most of the proxy rules if all of the conditions to the exemption are satisfied. In addition, the amendments state that a shareholder, issuer, or third party acting on behalf of a shareholder or issuer that establishes, maintains or operates an electronic shareholder forum will not be liable under the federal securities laws for any statement or information provided by another person participating in the forum. The amendments did not provide an exemption from Rule 14a–9 [17 CFR 240.14a–9], which prohibits fraud in connection with the solicitation of proxies.

[4] *See* 17 CFR 14b–1 and 14b–2; Timely Distribution of Proxy and Other Soliciting Material, Release No. 34–33768 (Mar. 16, 1994) [59 FR 13517].

[5] Delivery of Proxy Statements and Information Statements to Households, Release No. 33–7912 (Oct. 27, 2000) [65 FR 65736]. "Householding" permits a securities intermediary to send only one copy of proxy materials to multiple accounts within the same household under specified conditions. *Id.*

[6] *See, e.g.,* Proxy Disclosure Enhancements, Release No. 33–9089 (Dec. 16, 2009) [74 FR 68334] and Executive Compensation and Related Person Disclosure, Release No. 33–8732A (Aug. 9, 2006) [71 FR 53158].

[7] *See* Facilitating Shareholder Director Nominations, Release Nos. 33–9046, 34–60089, IC–287665 (June 10, 2009) [74 FR 29024].

[8] *See, e.g.,* Request for Rulemaking Concerning Shareholder Communications, April 12, 2004–Business Roundtable Petition 4–493 ("BRT Petition"); comment letter to Release No. 33–9046, note 7, above, from Altman Group; comment letters to Security Holder Director Nominations, Release No. 34–48626 (Oct. 14, 2003) [68 FR 60784] from Intel and Georgeson Shareholder Communications.

[9] Most commonly submitted to the Commission's Office of Investor Education and Advocacy, these complaints raise issues such as, for example, technical problems with electronic voting platforms offered by proxy service providers and failures by issuers to respond to shareholder complaints about proxy-related matters.

[10] *See* Broadridge 2009 Key Statistics and Performance Ratings, *available at http://www.broadridge.com/investor-communications/us/2009ProxyStats.pdf.*

[11] Order Approving Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors, Except for Companies Registered under the Investment Company Act of 1940, and to Codify Two Previously Published Interpretations that Do Not Permit Broker Discretionary Voting for Material Amendments to Investment Advisory Contracts with an Investment Company, Release No. 34–60215 (July 1, 2009) [74 FR 33293] (Commission approval of amendments to NYSE Rule 452).

[12] Historically, many corporate directors were elected under a plurality standard, which required only that a candidate receive more votes than other candidates, but not a majority of the votes. Since there ordinarily are not more candidates than seats, the election threshold has historically been low and shareholder participation was less important to electing directors. *See* American Bar Association Section of Business Law, Report of the Committee on Corporate Laws on Voting by Shareholders for the Election of Directors (Mar. 13, 2006), *available at http://www.abanet.org/buslaw/committees/CL270000pub/directorvoting/20060313000001.pdf.* From 2005 to 2007, however, a majority of companies in the S&P 500 index adopted a voting policy, through bylaw amendments or changes in corporate governance principles, that requires directors who do not receive a majority of votes cast at the meeting in favor of their election to tender their resignation to the board, which resignation the board may or may not accept. *See* Claudia H. Allen, *Study of Majority Voting in Director Elections* (Nov. 12, 2007), *available at http://www.ngelaw.com/files/upload/majoritystudy111207.pdf.*

[13] *See* Final Report of the Securities and Exchange Commission on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of such Securities Pursuant to Section 12(m) of the Securities Exchange Act of 1934, Dec. 3, 1976 (the "Street Name Study").

[14] The focus of this release is the U.S. proxy system. We recognize, however, that many U.S. persons hold shares in non-U.S. issuers. While this release does not address the processes and procedures followed by participants when non-U.S. issuers distribute proxy-related materials to U.S. persons, we are interested in information about those processes and procedures. We also seek comment about whether we should consider regulatory responses to issues that may arise in that area.

transparent to shareholders and to issuers. Studies of the proxy systems in other jurisdictions, including the United Kingdom and the European Union, have made similar observations.[15]

We begin this concept release with an overview of the U.S. proxy system. We then outline some of the concerns that have been raised regarding the accuracy, reliability, transparency, accountability, and integrity of this system, as well as possible regulatory responses to these concerns. These concerns generally relate to three principal questions:

- Whether we should take steps to enhance the accuracy, transparency, and efficiency of the voting process;
- Whether our rules should be revised to improve shareholder communications and encourage greater shareholder participation; and
- Whether voting power is aligned with economic interest and whether our disclosure requirements provide investors with sufficient information about this issue.

In reviewing the performance of the proxy system, the Commission's staff has recently had numerous discussions with a variety of participants in the proxy voting process, and we appreciate the insights these participants have provided.[16] While we set forth a number of general and specific questions, we welcome comments on any other concerns related to the proxy process that commentators may have, and we specifically invite comment on any costs, burdens or benefits that may result from possible regulatory responses identified in this release. We recognize that the various aspects of the proxy system that we address in this release are interconnected, and that changes to one aspect may affect other aspects, as well as complement or frustrate other potential changes.[17] We encourage the public to consider these relationships when formulating comments. Interested persons are also invited to comment on whether alternative approaches, or a combination of approaches, would better address the concerns raised by the current process.

We are mindful that, while we have recently amended—and are considering amending—a number of our rules that relate to the proxy process, further amendments to those rules or additional guidance about our views on their application may be appropriate to address concerns raised by the application of those rules. Although the discussion in this release generally focuses on the broader proxy system, we remain interested in ways to improve our proxy disclosure, solicitation, and distribution rules. We seek public comment on the concerns about those rules.

II. The Current Proxy Distribution and Voting Process

A fundamental tenet of state corporation law is that shareholders have the right to vote their shares to elect directors and to approve or reject major corporate transactions at shareholder meetings.[18] Under state law, shareholders can appoint a proxy to vote their shares on their behalf at shareholder meetings,[19] and the major national securities exchanges generally require their listed companies to solicit proxies for all meetings of shareholders.[20] Because most shareholders do not attend public company shareholder meetings in person, voting occurs almost entirely by the use of proxies that are solicited before the shareholder meeting,[21] thereby resulting in the corporate proxy becoming "the forum for shareholder suffrage."[22] Issuers with a class of securities registered under Section 12 of the Securities Exchange Act of 1934 ("Exchange Act") and issuers that are registered under the Investment Company Act of 1940 ("Investment Company Act") are required to comply with the federal proxy rules in Regulation 14A when soliciting proxies from shareholders.[23]

A. Types of Share Ownership and Voting Rights

The proxy solicitation process starts with the determination of who has the right to receive proxy materials and vote on matters presented to shareholders for a vote at shareholder meetings. The method for making this determination depends on the way the shares are owned. There are two types of security holders in the U.S.—registered owners and beneficial owners.

1. Registered Owners

Registered owners (also known as "record holders") have a direct relationship with the issuer because their ownership of shares is listed on records maintained by the issuer or its transfer agent.[24] State corporation law

[15] A report from the United Kingdom has characterized its voting process as one in which the chain of accountability is complex, where there is a lack of transparency and where there are a large number of different participants, each of whom may give a different priority to voting. *See* Review of the impediments to voting UK shares: Report by Paul Myners to the Shareholder Voting Working Group (Jan. 2004) ("Myners Report"). The European Union also has considered issues related to proxy voting and has enacted rules and legislation in response. As a result, the European Union passed a directive on the exercise of certain rights of shareholders in listed companies in July 2007, which covers many of the matters discussed in this release. *See* Directive 2007/36/EC of the European Parliament and of the Council (July 11, 2007) ("Shareholder Rights Directive"). The Shareholder Rights Directive addresses the issues of record dates, transparency, electronic communications, conflicts of interest, financial intermediaries and other parties involved in the proxy voting process.

[16] Beginning in September of 2009, the Commission's staff has met with representatives of the following groups and individuals to discuss issues about the U.S. proxy system: The Altman Group; Broadridge Financial Solutions, Inc.; Broadridge Steering Committee; Council of Institutional Investors ("CII"); Edwards, Angell, Palmer & Dodge; Glass, Lewis & Co.; the Hong Kong Securities & Futures Commission; International Corporate Governance Network ("ICGN"); InvestShare; McKenzie Partners; Mediant Communications; Moxy Vote; National Investor Relations Institute ("NIRI"); Proxy Governance, Inc.; RiskMetrics Group; Professor Edward Rock; Shareholder Communications Coalition; Securities Industry and Financial Markets Association ("SIFMA"); Society of Corporate Secretaries and Governance Professionals; Sodali; Target Corp.; TIAA–CREF; the U.K. Financial Reporting Council; and Weil, Gotshal & Manges, LLP. The staff has also been in communication with other regulators, including the Federal Reserve, FDIC, Office of the Comptroller of Currency, and Office of Thrift Supervision. Several of the above-listed parties provided written materials to the staff, which we are including in the public comment file for this release. The SEC Investor Advisory Committee has also recommended an inquiry into data-tagging proxy information, as described in Section IV.C below.

[17] For example, the feasibility of establishing a means of vote confirmation may depend on whether and to what extent we continue to allow beneficial owners to object to the disclosure of their identities to issuers. *See* Sections III.B and IV.A, below.

[18] *See, e.g.,* Del. Code Ann. tit. 8, §§ 211 and 212; Model Bus. Corp. Act §§ 7.01 and 7.21. While voting in the election of directors is largely the exclusive right of stockholders, state law may permit the corporation to grant voting rights to holders of other securities, such as debt. *See, e.g.,* Del. Code Ann. tit. 8, § 221. For a brief review of the rationale for voting by shareholders, *see* Frank H. Easterbrook and Daniel R. Fischel, The Economic Structure of Corporate Law (1991). We refer to Delaware law frequently because of the large percentage of public companies incorporated under that law. The Delaware Division of Corporations reports that over 50% of U.S. public companies are incorporated in Delaware. We refer to the Model Business Corporation Act as well because the corporate statutes of many states adopt or closely track its provisions.

[19] *See, e.g.,* Del Code Ann. tit. 8, § 212(b); Model Bus. Corp. Act § 7.22(b).

[20] *See, e.g.,* NYSE Listed Company Manual § 402.04(a); Nasdaq Listing Rule 5620(b).

[21] Although voting rights in public companies are exercised only at the meeting of shareholders, the votes cast at the meeting are almost entirely by proxy and the voting decisions have been made during the proxy solicitation process.

[22] *Roosevelt* v. *E.I duPont de Nemours & Co.,* 958 F.2d 416, 422 (D.C. Cir. 1992).

[23] 17 CFR 240.14a–1 *et seq.;* 17 CFR 270.20a–1. However, securities of foreign private issuers are exempt from the proxy rules. *See* 17 CFR 240.3a12–3.

[24] The Uniform Commercial Code ("UCC") defines the term "registered form," as applied to a certificated security, as a form in which the security certificate specifies a person entitled to the security, and a transfer of the security may be registered on books maintained for that purpose by or on behalf

generally vests the right to vote and the other rights of share ownership in registered owners.[25] Because registered owners have the right to vote, they also have the authority to appoint a proxy to act on their behalf at shareholder meetings.[26]

Registered owners can hold their securities either in certificated form [27] or in electronic (or "book-entry") form through a direct registration system ("DRS"),[28] which enables an investor to have his or her ownership of securities recorded on the books of the issuer without having a physical securities certificate issued.[29] Under DRS, an investor can electronically transfer his or her securities to a broker-dealer to effect a transaction without the risk, expense, or delay associated with the use of securities certificates. Investors holding their securities in DRS retain the rights of registered owners, without having the responsibility of holding and safeguarding securities certificates.

2. Beneficial Owners

The vast majority of investors in shares issued by U.S. companies today are beneficial owners, which means that they hold their securities in book-entry form through a securities intermediary, such as a broker-dealer or bank.[30] This is often referred to as owning in "street name." A beneficial owner does not own the securities directly. Instead, as a customer of the securities intermediary, the beneficial owner has an entitlement to the rights associated with ownership of the securities.[31]

B. The Process of Soliciting Proxies

The following diagram illustrates the flow of proxy materials that typically occurs during a solicitation. The steps illustrated in the diagram and descriptions of the relevant parties are discussed below.

of the issuer, or the security certificate so states. UCC 8–102(a)(13) (1994). Rule 14a–1 under the Exchange Act [17 CFR 240.14a–1] defines the term "record holder" for purposes of Rules 14a–13, 14b–1 and 14b–2 [17 CFR 240.14a–13, 14b–1, 14b–2] to mean any broker, dealer, voting trustee, bank, association or other entity that exercises fiduciary powers which holds securities on behalf of beneficial owners and deposits such securities for safekeeping with another bank. Additionally, the Commission's transfer agent rules refer to registered owners as security holders, which means owners of securities registered on the master security holder file of the issuer. Rule 17Ad–9 under the Exchange Act [17 CFR 240.17Ad–9] defines master security holder file as the official list of individual security holder accounts.

[25] *See, e.g.,* Del. Code Ann. tit. 8, § 219(c); Model Bus. Corp. Act § 1.40(21); *but see* Model Bus. Corp. Act § 7.23 (permitting corporations to establish procedures by which beneficial owners become entitled to exercise rights, including voting rights, otherwise exercisable by shareholders of record).

[26] *See, e.g.,* Del. Code Ann. tit. 8, § 212(b); Model Bus. Corp. Act § 7.22(b).

[27] A securities certificate evidences that the owner is registered on the books of the issuer as a shareholder. State commercial laws specify rules concerning the transfer of the rights that constitute securities and the establishment of those rights against the issuer and other parties. *See* Official comment to Article 8–101, The American Law Institute and National Conference of Commissioners of Uniform State Laws, Uniform Commercial Code, 1990 Official Text with Comments (West 1991).

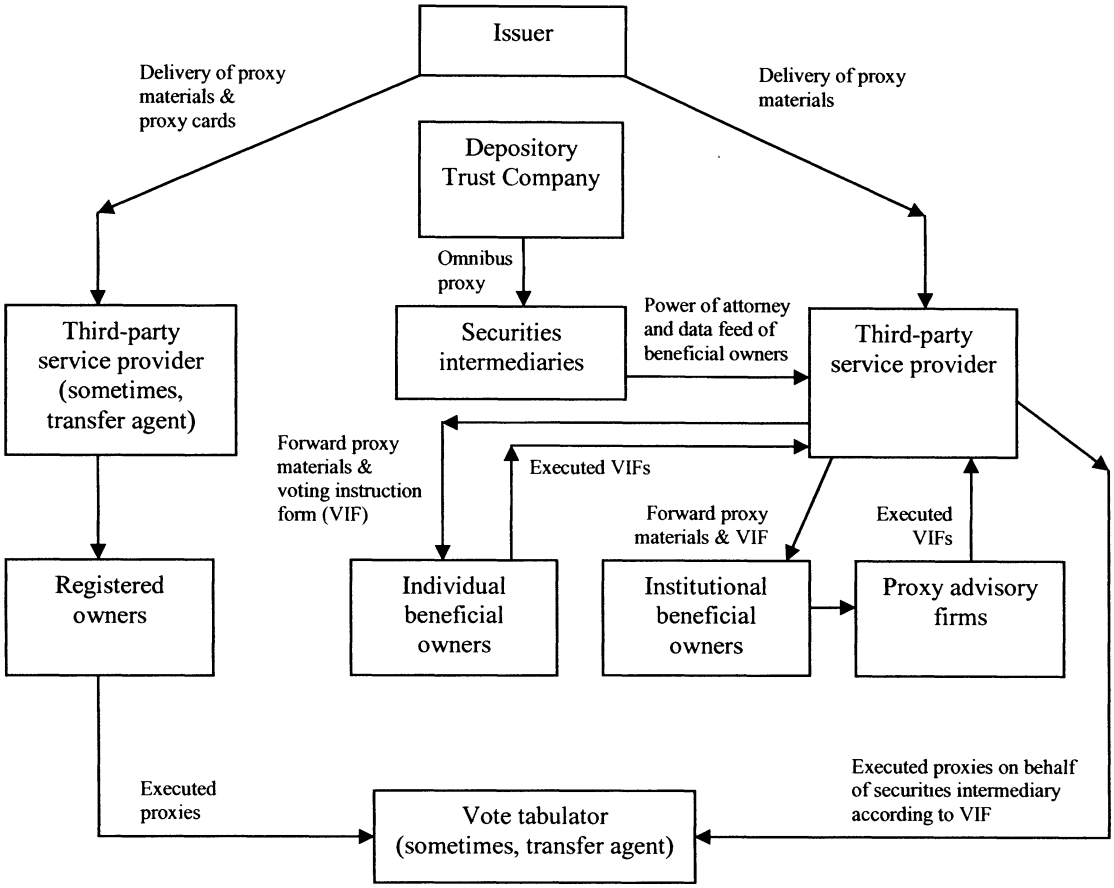
[28] For more information about DRS generally, *see* Securities Transactions Settlement, Release No. 33–8398 (Mar. 11, 2004) [69 FR 12922]. For a detailed description of DRS and the DRS facilities administered by DTC, *see* Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Procedures to Establish a Direct Registration System, Release No. 34–37931 (Nov. 7, 1996) [61 FR 58600] (order granting approval to establish DRS) and Notice of Filing of Amendment and Order Granting Accelerated Approval of a Proposed Rule Change Relating to Implementation of the Profile Modification System Feature of the Direct Registration System, Release No. 34–41862 (Sept. 10, 1999) [64 FR 51162] (order approving implementation of the Profile Modification System).

[29] DRS is an industry initiative aimed at dematerializing equities in the U.S. market. Dematerialization of securities occurs where there are no paper certificates available, and all transfers of ownership are made through book-entry movements. Immobilization of securities occurs where the underlying certificate is kept in a securities depository (or held in custody for the depository by the issuer's transfer agent) and transfers of ownership are recorded through electronic book-entry movements between the depository's participants' accounts. Securities are partially immobilized (as is the case with most U.S. equity securities traded on an exchange or securities association) when the street name positions are immobilized at the securities depository but certificates are still available to investors directly registered on the issuer's books. Although most options, municipal, government and many debt securities trading in the U.S. markets are currently dematerialized, many equity and some debt securities remain immobilized or partially immobilized at the Depository Trust Company ("DTC"). For more information about DTC, *see* Section II.B.2.a, below. Most if not all equity securities not on deposit at DTC but trading publicly in the U.S. markets remain fully certificated.

[30] For purposes of Commission rules pertaining to the transfer of certain securities, a "securities intermediary" is defined under Exchange Act Rule 17Ad–20 [17 CFR 240.17Ad–20] as a clearing agency registered under Exchange Act Section 17A [15 USC 78q–1] or a person, including a bank, broker, or dealer, that in the ordinary course of its business maintains securities accounts for others in its capacity as such. The UCC defines the term slightly differently, but for purposes of this release, this distinction is irrelevant. *See* UCC 8–102(a)(14) (1994).

[31] The rights and interests that a customer has against a securities intermediary's property are created by the agreements between the customer and the securities intermediary, as well as by the UCC, as adopted in the relevant jurisdiction. Under the UCC, beneficial owners have a "securities entitlement" to the fungible bulk of securities held by the broker-dealer or bank. An "entitlement holder" is defined as a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. UCC 8–503 (1994). A securities intermediary is obligated to provide the entitlement holder with all of the economic and governance rights that comprise the financial asset and that the entitlement holder can look only to that intermediary for performance of the obligations. *See generally* UCC 8–501 *et seq.* (1994).

Diagram 1: The Flow of Proxy Materials



1. Distributing Proxy Materials to Registered Owners

It is a relatively simple process for an issuer to send proxy materials to registered owners because their names and addresses are listed in the issuer's records, which are usually maintained by a transfer agent. As the left side of Diagram 1 illustrates, proxy materials are sent directly from the issuer through its transfer agent or third-party proxy service provider to all registered owners in paper or electronic form.[32] Registered owners execute the proxy card and return it to the issuer's transfer agent or vote tabulator for tabulation.

2. Distributing Proxy Materials to Beneficial Owners

As the right side of Diagram 1 illustrates, the process of distributing proxy materials to beneficial owners is more complicated than it is for registered owners. The indirect system of ownership in the U.S. permits securities intermediaries to hold securities for their customers, and there can be multiple layers of securities intermediaries leading to one beneficial owner. This potential for multiple tiers of securities intermediaries presents a number of challenges in the distribution of proxy materials.

a. The Depository Trust Company

In most cases, the chain of ownership for beneficially owned securities of U.S. companies begins with the Depository Trust Company ("DTC"), a registered clearing agency acting as a securities depository.[33] Most large U.S. broker-dealers and banks are DTC participants, meaning that they deposit securities with, and hold those securities through, DTC.[34] DTC's nominee, Cede & Co., appears in an issuer's stock records as the sole registered owner of securities deposited at DTC. DTC holds the deposited securities in "fungible bulk," meaning that there are no specifically identifiable shares directly owned by DTC participants.[35] Rather, each

[32] Commission rules provide, generally, that proxy materials can be provided electronically to shareholders who have affirmatively consented to electronic delivery. *See* Use of Electronic Media for Delivery Purposes, Release No. 33–7233 (Oct. 6, 1995) [60 FR 53458]. In addition, the Commission has adopted the notice and access model that permits issuers to send shareholders a Notice of Internet Availability of Proxy Materials in lieu of the traditional paper packages including the proxy statement, annual report and proxy card. *See* Notice and Access Release, note 2, above. These two concepts work in tandem. Although an issuer electing to send a Notice in lieu of a full package generally would be required to send a paper copy of that Notice, it may send that Notice electronically to a shareholder who has provided an affirmative consent to electronic delivery.

[33] DTC provides custody and book-entry transfer services of securities transactions in the U.S. market involving equities, corporate and municipal debt, money market instruments, American depositary receipts, and exchange-traded funds. In accordance with its rules, DTC accepts deposits of securities from its participants (*i.e.,* broker-dealers and banks), credits those securities to the depositing participants' accounts, and effects book-entry movements of those securities. For more information about DTC, *see http://www.dtcc.com/about/subs/dtc.php.*

[34] Participants in DTC are usually broker-dealers or banks. Currently, there are approximately 400 DTC participants. *See http://www.dtcc.com/customer/directories/dtc/dtc.php.* Other jurisdictions have entities similar to the DTC. For example, Canada has the Clearing and Depository Services Inc., which is its national securities depository and clearing and settlement entity.

[35] *See* UCC 8–503(b) (1994) (a beneficial owner's property interest with respect to shares "is a pro rata property interest in all interests in that financial asset held by the securities intermediary").

participant owns a pro rata interest in the aggregate number of shares of a particular issuer held at DTC. Correspondingly, each customer of a DTC participant—such as an individual investor—owns a pro rata interest in the shares in which the DTC participant has an interest.

Once an issuer establishes a date for the shareholder meeting and a record date for shareholders entitled to vote on matters presented at the meeting, it sends a formal announcement of these dates to DTC, which DTC forwards to all of its participants.[36] The issuer then requests from DTC a "securities position listing"[37] as of the record date, which identifies the participants having a position in the issuer's securities and the number of securities held by each participant.[38] DTC must promptly respond by providing the issuer with a list of the number of shares in each DTC participant's account as of the record date.[39] The record date securities position listing establishes the number of shares that a participant is entitled to vote through its DTC proxy.[40]

For each shareholder meeting, DTC executes an "omnibus proxy"[41] transferring its right to vote the shares held on deposit to its participants.[42] In this manner, broker-dealer and bank participants in DTC obtain the right to vote directly the shares that they hold through DTC.

b. Securities Intermediaries: Broker-Dealers and Banks

Once the issuer identifies the DTC participants holding positions in its securities, it is required to send a search card[43] to each of those participants, as well as other securities intermediaries that are registered owners, to determine whether they are holding shares for beneficial owners and, if so, the number of sets of proxy packages needed to be forwarded to those beneficial owners. This process may involve multiple tiers of securities intermediaries holding securities on behalf of other securities intermediaries, with search cards distributed to each securities intermediary in the chain of ownership.

Commission rules require broker-dealers to respond to the issuer within seven business days with the approximate number of customers of the broker-dealer who are beneficial owners of the issuer's securities.[44] The Commission's rules also require banks to follow a similar process except that banks must respond to the issuer within one business day with the names and addresses of all respondent banks[45] and must respond within seven business days with the approximate number of customers of the bank who are beneficial owners of shares.[46]

Once the search card process is complete, the issuer should know the approximate number of beneficial owners owning shares through each securities intermediary. The issuer must then provide the securities intermediary, or its third-party proxy service provider, with copies of its proxy materials (including, if applicable, a Notice of Internet Availability of Proxy Materials) for forwarding to those beneficial owners. The securities intermediary must forward these proxy materials to beneficial owners no later than five business days after receiving such materials.[47] Securities intermediaries are entitled to reasonable reimbursement for their costs in forwarding these materials.[48]

Instead of receiving and executing a proxy card (as registered owners receive and do), the beneficial owner receives a "voting instruction form" or "VIF" from the securities intermediary, which permits the beneficial owner to instruct the securities intermediary how to vote the beneficially owned shares. Although the VIF does not give the beneficial owner the right to attend the meeting, a beneficial owner typically can attend the meeting by requesting the appropriate documentation from the securities intermediary.

C. Proxy Voting Process

Once the proxy materials have been distributed to the registered owners and beneficial owners of the securities, the means by which shareholders vote their shares differs. As Diagram 1 illustrates, registered owners execute the proxy card and return it to the vote tabulator, either by mail, by phone, or through the Internet. Beneficial owners, on the other hand, indicate their voting instructions on the VIF and return it to the securities intermediary or its proxy service provider, either by mail, by phone, or through the Internet.[49] The securities intermediary, or its proxy service provider, tallies the voting instructions

[36] NYSE-listed issuers are also required to provide the NYSE with notification of the record and meeting dates. *See* NYSE Listed Company Manual § 401.02.

[37] Exchange Act Rule 17Ad–8 defines a "securities position listing" as a list of those participants in the clearing agency on whose behalf the clearing agency holds the issuer's securities and of the participant's respective positions in such securities as of a specified date. 17 CFR 240.17Ad–8(a).

[38] Pursuant to Exchange Act Rule 17Ad–8, DTC may charge issuers requesting securities position listings a fee designed to recover the reasonable costs of providing the list. 17 CFR 240.17Ad–8(b). An issuer or its agent, generally a transfer agent or authorized third-party service provider, can subscribe to DTC's service that allows the subscriber to obtain the securities position listing once or on a weekly, monthly, or more frequent basis.

[39] Upon request, a registered clearing agency must furnish a securities position listing promptly to each issuer whose securities are held in the name of the clearing agency or its nominee. 17 CFR 140.17Ad–8(b).

[40] In addition to the shares held in its DTC account, some participants may also own additional securities at other securities depositories, through custodians, or in registered form.

[41] Rather than issue each participant a separate proxy to vote its shares, DTC drafts a single proxy (the "omnibus proxy") granting to each of the multiple participants listed in the proxy the right to vote the number of shares attributed to it in the omnibus proxy.

[42] As noted in recent litigation, the execution by DTC of an omnibus proxy is neither automatic nor legally required, but occurs as a matter of common practice. *Kurz* v. *Holbrook,* 989 A.2d 140, 170 (Del. Ch. 2010), *rev'd on other grounds, Crown EMAK Partners, LLC* v. *Kurz,* 992 A.2d 377 Del. 2010) ("There does not appear to be any authority governing *when* a DTC omnibus proxy is issued, who should ask for it, or what event triggers it. The parties tell me that DTC has no written policies or procedures on the matter.").

[43] The search card must request: (1) The number of beneficial owners; (2) the number of proxy soliciting materials and annual reports needed for forwarding by the intermediaries to their beneficial owner customers; and (3) the name and address of any agent appointed by the bank or broker-dealer to process a request for a list of beneficial owners. The search card must be sent out at least 20 business days prior to the record date unless impracticable, in which case it must be sent as many days before the record date as practicable. 17 CFR 240.14a–13(a).

[44] 17 CFR 240.14b–1(b)(1).

[45] A respondent bank is a bank that holds securities through another bank that is the record holder of those securities. *See* Facilitating Shareholder Communications, Release No. 34–23276 (May 29, 1986) [51 FR 20504].

[46] 17 CFR 240.14b–2(b)(1) and 17 CFR 240.14b–2(b)(2). Banks are required to execute omnibus proxies in favor of respondent banks. 17 CFR 240.14b–2(b)(2).

[47] 17 CFR 240.14b–1(b)(2) and 17 CFR 240.14b–2(b)(3). The exchanges have rules that regulate the process and procedures by which member firms must transmit proxy materials to beneficial owners, collect voting instructions from beneficial owners, and vote shares held in the member firm's name. *See, e.g.,* NYSE Rules 450 through 460 and FINRA Rule 2251.

[48] 17 CFR 240.14a–13(a)(5). In addition, most of the exchanges have rules specifying the maximum rates that member firms may charge listed issuers as reasonable reimbursement. For example, the NYSE rule includes a schedule of "fair and reasonable rates of reimbursement" of member broker-dealers for their out-of-pocket expenses, including reasonable clerical expenses, incurred in connection with issuers' proxy solicitations of beneficial owners. NYSE Rule 465 Supplemental Material. The other exchanges have similar rules. See the discussion on proxy distribution fees in Section III.D below.

[49] Beneficial owners' voting instructions submitted by telephone account for a very small percentage of votes received by proxy service providers; for the shares of most beneficial owners who do not vote through a proprietary service for institutional investors, voting instructions are conveyed by paper or via the Internet, in approximately the same proportion. *See* Broadridge 2009 Key Statistics and Performance Ratings, note 10, above.

that it receives from its customers. As discussed in further detail in Section IV.A of this release, the securities intermediary, or its proxy service provider, then executes and submits to the vote tabulator a proxy card for all securities held by the securities intermediary's customers.[50]

In certain situations, a broker-dealer may use its discretion to vote shares if it does not receive instructions from the beneficial owner of the shares. Historically, broker-dealers were generally permitted to vote shares on uncontested matters, including uncontested director elections, without instructions from the beneficial owner.[51] The NYSE recently revised this rule to prohibit broker-dealers from voting uninstructed shares with regard to any election of directors.[52]

D. The Roles of Third Parties in the Proxy Process

Issuers, securities intermediaries, and shareholders often retain third parties to perform a number of proxy-related functions, including forwarding proxy materials, collecting voting instructions, voting shares, soliciting proxies, tabulating proxies, and analyzing proxy issues.

1. Transfer Agents

Issuers are required to maintain a record of security holders for state law purposes[53] and often hire a transfer agent[54] to maintain that record.[55] Transfer agents, as agents of the issuer, are obliged to confirm to a vote tabulator (if the transfer agent does not itself perform the tabulation function) matters such as the amount of shares outstanding, as well as the identity and holdings of registered owners entitled to vote. Transfer agents are required to register with the Commission, which inspects and currently regulates some of their functions.[56]

2. Proxy Service Providers

To facilitate the proxy material distribution and voting process for beneficial owners, securities intermediaries typically retain a proxy service provider to perform a number of processing functions, including forwarding the proxy materials by mail or electronically and collecting voting instructions.[57] To enable the proxy service provider to perform these functions, the securities intermediary gives the service provider an electronic data feed of a list of beneficial owners and the number of shares held by each beneficial owner on the record date. The proxy service provider, on behalf of the intermediary, then requests the appropriate number of proxy material sets from the issuer for delivery to the beneficial owners. Upon receipt of the packages, the proxy service provider, on behalf of the intermediary, mails either the proxy materials with a VIF, or a Notice of Internet Availability of Proxy Materials,[58] to beneficial owners. Although we do not directly regulate such proxy service providers, our regulations governing the proxy process-related obligations of securities intermediaries apply to the way in which proxy service providers perform their services because they act as agents for, and on behalf of, those intermediaries and typically vote proxies on behalf of those intermediaries pursuant to a power of attorney.

3. Proxy Solicitors

Issuers sometimes hire third-party proxy solicitors to identify beneficial owners holding large amounts of the issuers' securities and to telephone shareholders to encourage them to vote their proxies consistent with the recommendations of management. This often occurs when there is a contested election of directors, and issuer's management and other persons are competing for proxy authority to vote securities in the election (commonly referred to as a "proxy contest"). In addition, an issuer may hire a proxy solicitor in uncontested situations when voting returns are expected to be insufficient to meet state quorum requirements or when an important matter is being considered. Issuers and other soliciting persons are required to disclose the use of such services and estimated costs for such services in their proxy statements.[59]

4. Vote Tabulators

Under many state statutes, an issuer must appoint a vote tabulator (sometimes called "inspectors of elections" or "proxy tabulators") to collect and tabulate the proxy votes as well as votes submitted by shareholders in person at a meeting.[60] We understand that often the issuer's transfer agent will act as the vote tabulator because most

[50] As noted above, the securities intermediary receives the right to execute a proxy through the omnibus proxy executed in its favor by DTC and the other securities intermediaries in the chain of ownership through which it holds the securities. Although Rule 14b–2(b)(3) [17 CFR 240.14b–2(b)(3)] explicitly permits a bank to execute a proxy in favor of its beneficial owners, and nothing in our rules prohibits a broker-dealer from doing so, it is our understanding that these intermediaries usually solicit voting instructions from their beneficial owner and execute proxies on behalf of their beneficial owners rather than executing proxies that delegate their voting authority to those beneficial owners. Beneficial owners may, however, request a proxy and attend the shareholder meeting. It is our understanding that both banks and broker-dealers will issue a proxy that the beneficial owner may use to attend a meeting if requested to do so.

[51] *See* NYSE Rule 452.

[52] NYSE Rule 452 and NYSE Listed Issuer Manual § 402.08(B). This prohibition does not apply to issuers registered under the Investment Company Act.

[53] *E.g.,* Del. Code Ann. tit. 8, § 219(a); Model Bus. Corp. Act § 16.01(c).

[54] Section 3(a)(25) of the Exchange Act defines a "transfer agent" as any person who engages on behalf of an issuer of securities or on behalf of itself as an issuer of securities in (1) countersigning such securities upon issuance, (2) monitoring the issuance of such securities with a view to preventing unauthorized issuance, (3) registering the transfer of securities, (4) exchanging or converting such securities, or (5) transferring record ownership of securities by bookkeeping entry without the physical issuance of securities certificates. For more information about the role of transfer agents, *see http://www.stai.org.*

[55] Exchange Act Rules 17Ad–6, 17Ad–7, 17Ad–9, 17Ad–10, and 17Ad–11 govern how transfer agents acting for issuers of securities registered under Section 12 of the Exchange Act (or that would have to be registered but for the exemption under Section 12(g)(2)(b)(i) and (ii) of the Exchange Act) must maintain certain records of the issuer, including, but not limited to, the official record of ownership (*i.e.,* the "masterfile") and the official record of the number of securities issued and outstanding (*i.e.,* the "control book" or the "registrar"). These rules do not address the distribution of issuer communications, including proxy materials, or the remittance of proxies or voting instructions. To a lesser extent, the UCC, as adopted by states, also governs certain aspects of transfer agent activity relating to rights of issuers, shareholders, securities intermediaries, and those holding through securities intermediaries, some of which relate to the right to vote. The application of the UCC in this context is beyond the scope of this release.

[56] Persons acting as transfer agents for any security registered under Section 12 of the Exchange Act or which would be required to be registered except for the exemption from registration provided by subsection (g)(2)(B) or (g)(2)(G) of Section 12 must register with the Commission (or, for transfer agents that are banks, with their appropriate regulatory agency) and pursuant to Section 17A of the Exchange Act must comply with Commission rules and regulations. 15 U.S.C. 78q–1(c)(1) and (d)(1).

[57] A single proxy service provider, Broadridge Financial Services, Inc. ("Broadridge"), states that it currently handles over 98% of the U.S. market for such proxy vote processing services. *See http://www.broadridge.com/investor-communications/us/institutions/proxy-disclosure.asp.*

[58] A Notice is sent pursuant to provisions in Rule 14a–16. 17 CFR 240.14a–16.

[59] Item 4 of 17 CFR 240.14a–101. If similar services are performed by employees of the issuer, however, the estimated costs of such services need to be disclosed only if the employees are specially engaged for the solicitation.

[60] *See, e.g.,* Del. Code Ann. tit. 8, § 231; Model Bus. Corp. Act § 7.29.

major transfer agents have the infrastructure to communicate with registered holders, proxy service providers, and securities intermediaries, while also being able to reconcile the identity of voters that are registered owners and the number of votes to the issuer's records. However, sometimes the issuer will hire an independent third party to perform this function, often to certify important votes. The vote tabulator is ultimately responsible for determining that the correct number of votes has been submitted by each registered owner.[61] In addition, proxies submitted by securities intermediaries that are not registered owners, but have been granted direct voting rights through DTC's omnibus proxy, are reconciled with DTC's securities position listing. Although the Commission does regulate transfer agents (which often serve as vote tabulators) in their roles as transfer agents, the Commission does not currently regulate vote tabulators or the function of tabulating proxies by transfer agents.

5. Proxy Advisory Firms

Institutional investors typically own securities positions in a large number of issuers. Therefore, they are presented annually with the opportunity to vote on many matters and often must exercise fiduciary responsibility in voting.[62] Some institutional investors may retain an investment adviser to manage their investments, and may also delegate proxy voting authority to that adviser. To assist them in their voting decisions, investment advisers (or institutional investors if they retain voting authority) frequently hire proxy advisory firms to provide analysis and voting recommendations on matters appearing on the proxy. In some cases, proxy advisory firms are given authority to execute proxies or voting instructions on behalf of their client. Some proxy advisory firms also provide consulting services to issuers on corporate governance or executive compensation matters, such as helping to develop an executive compensation proposal to be submitted for shareholder approval. Some proxy advisory firms may also qualitatively rate or score issuers, based on judgments about the issuer's governance structure, policies, and practices. As discussed in more detail elsewhere in this release, some of the activities of a proxy advisory firm can constitute a solicitation, which is governed by our proxy rules.[63] Some, but not all, proxy advisory firms operating in our markets are currently registered with us as investment advisers.[64]

III. Accuracy, Transparency, and Efficiency of the Voting Process

Investor and issuer interests may be undermined when perceived defects in the proxy system—or uncertainties about whether there are any such defects—are believed to impair its accuracy, transparency, and cost-efficiency. Because even the perception of such defects can lead to lack of confidence in the proxy process, we seek to explore concerns that have been expressed about the accuracy, transparency, and efficiency of that process and ways in which those concerns might be addressed.

A. Over-Voting and Under-Voting

On occasion, vote tabulators (including transfer agents acting in that capacity) receive votes from a securities intermediary that exceed the number of shares that the securities intermediary is entitled to vote. The extent to which such votes are accepted depends on instructions from the issuer, state law, and the vote tabulator's internal policies. For example, it is our understanding that some vote tabulators accept votes from a DTC participant on a "first-in" basis up to the aggregate amount indicated in DTC's records—that is, once the votes cast by the participant exceed the number of positions indicated on the securities position listing, the vote tabulator will refuse to accept any votes subsequently remitted. Conversely, other vote tabulators, we understand, refuse to accept any votes from a securities intermediary if the aggregate number of votes submitted exceeds the vote tabulator's records for that intermediary.

In an attempt to address issuers' concerns about the potential for over-voting, securities intermediaries and their service providers have implemented systems that compare the number of votes submitted by a securities intermediary to its ownership positions as reflected in DTC's records and notify that securities intermediary when it has submitted votes in excess of its ownership positions. The securities intermediary may then adjust its vote to reflect the correct number of votes before the service provider submits that vote to the vote tabulator.[65] The corrected information is then sent to the vote tabulator. The means by which securities intermediaries reconcile these differences has raised some concern regarding the accuracy of the vote, including whether the votes are being allocated to the beneficial owners in the correct amounts.

1. Imbalances in Broker Votes

For securities held at DTC, a DTC participant may vote only the number of securities held by that participant in its DTC account on the record date for a shareholder meeting. Sometimes the number of securities of a particular issuer held in the DTC participant's account will be less than the number of securities that the DTC participant has credited in its own books and records to its customers' accounts. Although there may be many reasons why the number of securities held by a broker-dealer at DTC does not match the total number of securities credited to the broker-dealer's customers' accounts, as discussed in more detail below, this situation principally arises in connection with lending transactions and "fails to deliver"[66] in the clearance and settlement system.

Because of the way broker-dealers track securities lending transactions,[67] if all of a broker-dealer's customers owning a particular issuer's securities actually voted, the broker-dealer may receive voting instructions for more securities than it is entitled to vote. Moreover, the existing clearance and settlement system was not designed to assign particular shares of a security to a particular investor, due to netting and holding securities in fungible bulk.[68] Thus, it is not currently possible to match a particular investor's vote to a specific securities position held at a securities depository. When a broker-dealer has fewer positions or shares reflected on the securities position listing[69] than it has reflected on its books and records, the broker-dealer must determine if and how it should allocate the votes it has among its customer and proprietary accounts and

[61] *Id.* As noted above, transfer agents, who already possess the list of record owners, often tabulate the vote, so they possess the necessary information to make this determination. It is our understanding that, when the vote tabulator is an entity other than the transfer agent, the issuer or its transfer agent typically will provide the vote tabulator with the list of record owners to enable the vote tabulator to make this determination.

[62] *See* Section V.A.1, below.

[63] *Id.*

[64] *Id.*

[65] SIFMA and individual broker-dealers have suggested several different methodologies as to how this may be accomplished, but we do not believe there is consensus among the industry participants or a standard operating procedure currently in place.

[66] *See* Section III.A.1.b, below.

[67] We understand that because securities are held in fungible bulk, broker-dealers typically do not allocate loaned securities to a particular account.

[68] *See* Section IV.A.1, below.

[69] See Section I.B.2.a, above, for a discussion of securities position listings.

then reconcile the actual voting instructions it receives with the number of securities the broker-dealer is permitted to vote with the issuer. Depending on a variety of factors, this process can lead to over-voting or under-voting by beneficial owners.

a. Securities Lending

When a customer purchases shares on margin, a portion of the securities in the customer's account may be used to collateralize the margin loan.[70] As part of the customer's margin agreement, the customer typically agrees to allow the broker-dealer to use those securities to raise money to fund the margin loan. Consequently, broker-dealers may lend out customers' margin securities. In addition, broker-dealers may enter into stock loan arrangements with investors (typically institutional investors or other broker-dealers) whereby the broker-dealer borrows the investors' fully-paid securities.[71]

Stock loan agreements typically transfer to the borrower the right to vote the borrowed securities.[72] Thus, for example, when an institutional investor, such as a fund, lends its portfolio securities to a borrower, the right to vote those securities also transfers to the borrower.[73] As a result, the institutional investor that lends its portfolio securities generally loses its ability to vote those securities, unless and until the loan is terminated and the securities are returned before the record date in question.[74]

Even though a broker-dealer has the ability to lend its customers' margin securities pursuant to a stock loan agreement, because shares are held in fungible bulk, it may not be practical to inform a customer when an actual loan has been made and it may be unclear which lending investor has lost the right to vote. Therefore, a customer may expect to vote all of its securities because it does not necessarily know whether its securities have in fact been loaned. If the lending broker-dealer does not allocate a certain number of shares to a lending investor as having been borrowed, but instead sends a VIF indicating that the lending investor has the right to vote all of the securities credited to its account, including the loaned margin securities, both the lending and borrowing broker-dealers may submit voting instructions from two customers for a single share, which may give rise to an over-voting situation.

b. Fails to Deliver

An imbalance between a securities intermediary's position reflected on the securities position listing and the position reflected in its own books and records may also occur because of fails to deliver in the clearance and settlement system.[75] Every day the NSCC, a registered clearing agency, nets each of its members' trades to a single buy or sell obligation for each issue traded.[76] Because NSCC acts as a central counterparty for its members' trades, its members are obligated to deliver securities to, and entitled to receive securities from, NSCC at settlement, and not to or from other broker-dealers. Although the delivery of securities usually occurs as expected on the settlement date, there are occasions when broker-dealers fail to make timely delivery, often for reasons outside of their control.[77]

Pursuant to NSCC rules, if an NSCC broker-dealer member "fails to deliver" the securities it owes to NSCC on the settlement date, NSCC will allocate this fail to one of many contra-side broker-dealers due to receive securities without trying to attribute the fail to the specific broker-dealer that originally traded with the broker-dealer that failed to deliver.[78] The broker-dealer to which the fail is allocated will not receive the securities and will not be credited with this position at DTC until delivery is actually made.

Even though the broker-dealer has not actually received the securities, the broker-dealer usually will credit its customers' accounts with the purchased securities on settlement date. If the broker-dealer's fail-to-receive position continues through the record date for a corporate election, DTC may not yet recognize the broker-dealer's entitlement to vote this position. As with loaned securities, the broker-dealer may still try to allocate votes to all of its customers that its records reflect as owning those securities, even though DTC has not credited the broker's account with those securities or with the corresponding right to vote those securities through DTC.

2. Current Reconciliation and Allocation Methodologies Used by Broker-Dealers To Address Imbalances

Because the ownership of individual shares held beneficially is not tracked in the U.S. clearance and settlement system, when imbalances occur, broker-dealers must decide which of their customers will be permitted to vote and how many shares each customer will be permitted to vote. Neither our rules nor SRO rules currently mandate that a reconciliation be performed, or the use of a particular reconciliation or allocation methodology. Broker-dealers have developed a number of different approaches as to how votes are "allocated" among customer accounts.[79]

[70] A broker-dealer must maintain possession and control of all fully-paid and excess margin securities. 17 CFR 240.15c3–3(b)(1).

[71] When borrowing fully-paid securities, Exchange Act Rule 15c3–3(b)(3) requires, among other things, that a broker-dealer enter into a separate written agreement with the customer and provide the customer with a schedule of the securities actually borrowed as well as the collateral provided to the customer. 17 CFR 240.15c3–3(b)(3).

[72] *See* Master Securities Lending Agreement at 6, *available at www.sifma.org/services/stdforms/pdf/master_sec_loan.pdf.*

[73] If an institutional lender lends out portfolio securities after the record date for a particular shareholder vote, the lender would normally retain the right to vote the proxies for that particular shareholder vote.

[74] If the lending broker-dealer attempts to recall the loan, the borrowing broker-dealer may not be able to return the securities in a timely manner because, among other things, it may have reloaned or sold the security to another party and is unable to obtain shares to return to the lending broker-dealer.

[75] Fails to deliver in all equity securities have declined significantly since the adoption of Interim Final Temporary Rule 204T in October 2008. *See* Amendments to Regulation SHO, Release No. 34–58773 (Oct. 14, 2008) [73 FR 61706]. *See also* Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Nov. 4, 2009, *available at http://www.sec.gov/spotlight/shortsales/oeamemo110409.pdf* (stating, among other things, that the average daily number of aggregate fails to deliver for all securities decreased from 2.21 billion to 0.25 billion for a total decline of 88.5% when comparing a pre-Rule to post-Rule period); Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Nov. 26, 2008, *available at http://www.sec.gov/comments/s7-30-08/s73008-37.pdf*; Memorandum from the Staff Re: Impact of Recent SHO Rule Changes on Fails to Deliver, Mar. 20, 2009, *available at http://www.sec.gov/comments/s7-30-08/s73008-107.pdf.*

[76] NSCC nets securities in its "Continuous Net Settlement" system pursuant to rules and procedures approved by the Commission. For more information on NSCC's rules and procedures, see *www.dtcc.com/legal/rules_proc/nscc_rules.pdf.* See Section IV.A.1, below, for additional information about the role of NSCC.

[77] For example, broker-dealers may fail to deliver securities because of: (1) Delays by customers delivering to the broker-dealer the shares being sold; (2) a broker-dealer's inability to purchase or borrow shares needed for settlement; or (3) a broker-dealer's inability to obtain transfer of title of securities in time for settlement. For more information on fails to deliver in the U.S. clearance and settlement system, see Short Sales, Release No. 34–50103 (July 28, 2004) [69 FR 48008] and Amendments to Regulation SHO, Release No. 34–60388 (July 27, 2009) [74 FR 38266].

[78] If a broker-dealer fails to deliver securities to NSCC, NSCC allocates this fail to a broker-dealer member that is due to receive the securities.

[79] For more information on proxy processing and broker-dealer's reconciliation and allocation processes, see "Briefing Paper: Roundtable on Proxy Voting Mechanics," (May 24, 2007), *available at http://www.sec.gov/spotlight/proxyprocess/proxyvotingbrief.htm* ("Roundtable Briefing Paper"), or "Unofficial Transcript of the Roundtable Discussion on Proxy Voting Mechanics," (May 24, 2007), *available at http://www.sec.gov/news/openmeetings/2007/openmtg_trans052407.pdf*

We understand that these approaches are often influenced by whether the broker-dealers' customers are primarily retail or institutional investors.

Most broker-dealers have adopted a reconciliation method to balance the aggregate number of shares they are entitled to vote with the aggregate number of shares credited to customer and proprietary accounts.[80] The primary reconciliation methods are: (1) Pre-mailing reconciliation ("pre-reconciliation"); (2) post-mailing reconciliation ("post-reconciliation"); and (3) a hybrid form of the pre-reconciliation and post-reconciliation methods.[81] These methods are described in more detail below. If the broker-dealer finds that it is holding fewer shares at DTC than it has credited to customer and proprietary accounts, it may choose to give up its own votes, as represented by shares credited to its proprietary accounts, by allocating some or all of those votes to its customers, or it may choose to allocate to its customers only the voting rights attributable to customer accounts.

a. Pre-Reconciliation Method

A broker-dealer using the pre-reconciliation method compares the number of shares it holds in aggregate at DTC and elsewhere with its aggregate customer account position before it sends VIFs to its customers.[82] If the aggregate number of shares it holds is less than the number of shares the broker-dealer has credited to its customer accounts, then the broker-dealer will determine which of its customers will be permitted to vote and how many votes will be allocated to each of those customers. Broker-dealers using the pre-reconciliation method request voting instructions from their customers with respect to only those customer positions to which votes have been allocated. We understand that most broker-dealers give customers with fully-paid securities and excess margin securities first priority in the distribution of votes. It is also our understanding that broker-dealers using the pre-reconciliation method tend to have more institutional customers than retail customers.[83]

Broker-dealers using the pre-reconciliation method have indicated that this method ensures that the votes customers cast will be counted.[84] On the other hand, given that some broker-dealers have estimated that only 20% to 30% of their retail customers usually vote, some believe that pre-reconciliation may result in an "under-vote" because investors allocated the ability to vote may not do so, and other investors who do vote may be allocated a number of votes fewer than the number of shares they beneficially own. In addition, some broker-dealers have indicated that the pre-reconciliation method is more expensive than the post-reconciliation method because post-reconciliation only needs to be performed when a broker-dealer receives voting instructions in excess of the number of shares that it holds.

b. Post-Reconciliation Method

A broker-dealer using the post-reconciliation method compares its aggregate position at DTC and elsewhere[85] with its actual aggregate customer account position only after receiving VIFs from its customers. Broker-dealers using the post-reconciliation method request voting instructions from their customers with respect to all shares credited to their customer accounts, including for those shares that may have been purchased on margin, loaned to another entity, or not received because of a fail to deliver. We understand that broker-dealers using the post-reconciliation method tend to have primarily retail customers rather than institutional customers.[86]

In the event that a broker-dealer receives voting instructions from its customers in excess of its aggregate securities position, the broker-dealer adjusts its vote count prior to casting its vote with the issuer. The manner in which the adjustment is made varies among broker-dealers. Some firms simply reduce the number of proprietary position votes cast. Others allocate fewer votes to customers with securities purchased on margin or on loan.

Because of the low level of participation by retail voters, some of the broker-dealers using the post-reconciliation method have indicated to the Commission that the number of over-vote situations is not a significant problem and can be addressed in a number of ways, including, but not limited to, the broker-dealer using its proprietary positions to redress any imbalance. The costs associated with the post-reconciliation method are generally considered to be less than those associated with the pre-reconciliation method because the broker-dealer does not have to go through the costly process of allocating votes among customers unless its customers remit VIFs for more shares than the broker-dealer is entitled to vote in the aggregate.

c. Hybrid Reconciliation Methods

Some broker-dealers have developed hybrid reconciliation methods that use aspects of both pre- and post-reconciliation methods. For example, in one hybrid reconciliation method, a broker-dealer will allocate votes to all of its customers with fully-paid securities but will also allow each margin account customer to instruct the broker-dealer that it would like to vote its shares. The broker-dealer will allocate any shares not needed to cover fully-paid account holders to those margin customers who indicated they wanted to vote, thereby giving these margin customers priority over other margin customers.[87]

3. Potential Regulatory Responses

Broker-dealers have indicated to the Commission staff that most broker-dealers select an allocation and reconciliation method that best accommodates their particular customer base and best advances the firm's particular business strategy. For example, those firms focusing on retail customers generally will have more customer accounts owning smaller amounts of securities and casting relatively few votes and, as a result, may prefer the post-reconciliation method over the pre-reconciliation method.

The customers of a broker-dealer may not be aware of the allocation and reconciliation method used by the firm. We are interested in receiving views on whether it would be helpful to investors if broker-dealers publicly disclosed the allocation and reconciliation method used by the firm during each proxy season, as well as the likely effect of that method on whether the customers' voting instructions would actually be reflected in the broker-dealer's proxy sent to the vote tabulator. Such disclosure could be in writing and provided to customers upon opening an

("Roundtable Transcript"). The term "allocation" refers to the process by which a broker-dealer determines which of its customers will be allowed to vote and how many shares will be allotted to each of those customers.

[80] Not all broker-dealers have developed policies and procedures to address the reconciliation and allocation of votes among their customers because historically broker-dealers have usually had enough shares on deposit at DTC to provide a vote to all customers wanting to vote.

[81] Roundtable Transcript, note 79, above.

[82] *Id.*

[83] *Id.*

[84] *Id.*

[85] The aggregate number of shares the broker-dealer is entitled to vote may constitute more than just its position on deposit at DTC. For example, the broker-dealer may have additional securities on deposit at a foreign depository or in certificated form.

[86] Roundtable Transcript, note 79, above.

[87] *Id.*

account and on an annual basis, and made available to the general public on the broker-dealer's Web site. This disclosure could help investors to decide if a particular broker-dealer's method suits their investment goals. Alternatively, we are interested in receiving views on whether it would be beneficial to investors if broker-dealers were required to use a particular reconciliation method.

Given the lack of empirical data on whether over-voting or under-voting is occurring and if so, to what extent, we also would like to receive views on whether investors, issuers, and the proxy system overall would benefit from having additional data from proxy participants regarding over-voting and under-voting to determine whether further regulatory action should be considered. This data would allow us to determine the scope of the problem, if any, and give us detailed information that would further assist us in determining whether current regulations are effective or additional regulation is appropriate. Such information may also indicate if one particular method is working better for investors and the market than other methods.

4. Request for Comment

- What are the advantages or disadvantages of the various methods of allocation or reconciliation currently used by securities intermediaries and the effectiveness of such methods?
- Is there any evidence, statistical, anecdotal or otherwise, of material over-voting or under-voting, and if so, what is the size and impact of over-voting or under-voting? For example, is there any evidence that over-voting or under-voting has determined the outcome of a vote or materially changed the voting results?
- Are there any concerns caused by over-voting or under-voting that are not described above? Are there particular concerns regarding the impact of either over-voting or under-voting with respect to specific types of voting decisions, such as merger transactions, the election of directors where a majority vote is required, or shareholder advisory votes regarding executive compensation? What, if any, alternatives should we consider to the current system, and what would be the costs and benefits of any alternative process?
- Would requiring broker-dealers to disclose their allocation and reconciliation process adequately address the concerns related to over-voting and under-voting by beneficial owners?
- Would information about vote allocation and reconciliation methods be helpful to investors or adequately address any concerns related to those processes?
- Would a particular type of vote allocation and reconciliation method better protect investors' interests?
- Do the varying methods of vote allocation affect the potential to audit votes cast by beneficial holders?
- Should investors who have fully paid for their securities be allocated voting rights over those who purchased the securities on margin? Should beneficial holders be allocated voting rights over broker-dealer proprietary accounts?
- Should brokers be required to disclose the effect of share lending programs on the ability of retail investors to cast votes?
- Does the current system of settlement and clearance of securities transactions in the U.S. create any problems or inefficiencies in the proxy process in regard to matters other than over-voting or under-voting? If so, what are they, and what steps should we consider in order to address them?

B. Vote Confirmation

1. Background

A number of market participants, including both individual and institutional investors, have raised concerns regarding the inability to confirm whether an investor's shares have been voted in accordance with the investor's instructions. As discussed more fully in Section II, beneficial owners cast their votes through a securities intermediary, which, in turn, uses a proxy service provider to collect and send the votes to the vote tabulator.[88] Beneficial owners, particularly institutional investors, often want or need to confirm that their votes have been timely received by the vote tabulator and accurately recorded. Similarly, securities intermediaries want to be able to confirm to their customers that their votes have been timely received and accurately recorded. Issuers also want to be able to confirm that the votes that they receive from securities intermediaries on behalf of beneficial owners properly reflect the votes of those beneficial owners. We understand that, on occasion, errors have been made when a third party fails to timely submit votes on behalf of its clients.[89]

The inability to confirm voting information is caused in part because no one individual participant in the voting process—neither issuers, transfer agents, vote tabulators, securities intermediaries, nor third party proxy service providers—possesses all of the information necessary to confirm whether a particular beneficial owner's vote has been timely received and accurately recorded. A number of market participants contend that some proxy service providers, transfer agents, or vote tabulators are unwilling or unable to share voting information with each other or with investors and securities intermediaries. There are currently no legal or regulatory requirements that compel these entities to share information with each other in order to allow for vote confirmations.

The inability to confirm that votes have been timely received and accurately recorded creates uncertainty regarding the accuracy and integrity of votes cast at shareholder meetings. At a time when votes on matters presented to shareholders are increasingly meaningful and consequential to all shareholders, this lack of transparency could potentially impair confidence in the proxy system.[90] Because of the inability to ascertain the integrity of the votes cast by beneficial owners, concerns have been raised by investors that it may be difficult to assess the accuracy of the current proxy system as a whole.

2. Potential Regulatory Responses

In the Commission's view, both record owners and beneficial owners should be able to confirm that the votes they cast have been timely received and accurately recorded and included in the tabulation of votes, and issuers should be able to confirm that the votes that they receive from securities intermediaries/proxy advisory firms/

[88] Some securities intermediaries may not have sufficient shares on deposit at DTC to allocate a vote to every share position credited to every customer's account. In those cases, the securities intermediary may have to allocate a specific number of votes to some customers that is fewer than the number of shares credited to those customers' accounts. See Section III.A, above, for a more in-depth discussion of why and how securities intermediaries reconcile and allocate votes to their customers.

[89] *See, e.g.,* Adam Jones, "Riddle of the Missing Unilever Votes Solved," Financial Times, Aug. 15, 2003; "Mum on a Recount," Pensions & Investments, Aug. 10, 2009, *available at http://www.pionline.com/article/20090810/PRINTSUB/308109996;* Meagan Thompson-Mann, Policy Briefing No. 3—Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry, The Millstein Center for Corporate Governance and Performance, Mar. 2, 2009, at 10–11 ("Thompson-Mann Policy Briefing").

[90] The Organisation of Economic Co-operation and Development ("OECD"), consisting primarily of jurisdictions with high income and developed markets, has voiced similar concerns about this lack of transparency in several jurisdictions and recommends addressing it through legal and regulatory changes. *Corporate Governance: A Survey of OECD Countries* (2004) ("OECD Survey").

proxy service providers on behalf of beneficial owners properly reflect the votes of those beneficial owners. We understand that there may be a number of operational and legal complexities with any proposed solution and that the costs and benefits associated with any options should be carefully weighed.

One possible solution may be for all participants in the voting chain to grant to issuers, or their transfer agents or vote tabulators, access to certain information relating to voting records, for the limited purpose of enabling a shareholder or securities intermediary to confirm how a particular shareholder's shares were voted. To protect the identities of objecting beneficial owners from issuers, a system could assign each beneficial owner a unique identifying code, which could then be used to create an audit trail from beneficial owner to proxy service provider to transfer agent/vote tabulator. Issuers (or their agents, such as transfer agents or vote tabulators) would, in turn, confirm to record owners, beneficial owners, and securities intermediaries upon request that any particular votes cast by them or on their behalf have been received and voted as instructed. This process could be fully automated such that a vote confirmation could be provided by the issuer (or its agent) to the record owner or, in the case of beneficial owners, to the securities intermediary or proxy service provider and sent by e-mail to the beneficial owner.

Confirmation of the vote information may also facilitate the ability of market participants and state and federal regulatory authorities or courts to ascertain the accuracy of a particular election or the overall proxy system. Moreover, transparency of the process should promote investor confidence as well.

3. Request for Comment

- To what extent have shareholders had difficulty in confirming whether their submitted votes have been tabulated? To what extent have issuers had difficulty in determining whether the votes submitted by securities intermediaries/proxy advisory firms/proxy service providers accurately reflect the voting instructions submitted by beneficial owners?
- To what extent do investors believe that their votes have not been accurately transmitted or tabulated, and what is the basis for such belief? Is there sufficient information about the ways that investors actually place their votes, for example, by telephone, on paper, or via the Internet? [91] Do investors have concerns about whether the method they use to place their votes affects the likelihood that their vote will be accurately recorded?
- Should all participants in the voting chain grant access to their share voting records to issuers and their transfer agents/vote tabulators, for the limited purpose of enabling confirmation of a shareholder's vote? What are the benefits and costs associated with sharing such information?
- What is the best way to preserve any continuing anonymity of those investors who choose not to have their identities disclosed to the issuer?
- Would the creation of a unique identifier for each beneficial owner be feasible? Would such a system achieve the objective of allowing record owners and beneficial owners to confirm that their vote was cast in accordance with their instructions and confirm the number of shares cast on their behalf? What are the costs and benefits associated with such a system?
- Should issuers (and their agents) confirm to registered owners, beneficial owners, or securities intermediaries that the issuer has received and properly tabulated their votes? Should this confirmation be limited to an informal confirmation that votes have been counted, or should shareholders be able to obtain some form of proof that their votes have been counted? What type of documentation would constitute sufficient proof? What are the benefits and costs of such alternatives? Are there other steps that would enable beneficial owners to verify that their votes have been counted?
- Should investors also be able to obtain access to share voting records for the limited purpose of enabling an audit of the shareholder vote?
- Should issuers and securities intermediaries (and their agents) be required to reconcile and verify voting at the beneficial owner level? Would this be consistent with state law, which vests voting rights in the registered owner? Would other reconciliation and verification requirements be consistent with the purposes underlying state law?
- Should proxy participants periodically evaluate and test the effectiveness of their voting controls and procedures? If so, to whom should the results of these tests or the participants' conclusions on effectiveness be disclosed? Should disclosure be to the Commission, to clients, or also to the public?

C. Proxy Voting by Institutional Securities Lenders

Institutional securities lenders play a significant role in the proxy voting process, and we believe that it is important to evaluate the impact of their share lending on that process, and to consider ways in which the efficacy and transparency of share voting on the part of such institutions could potentially be improved. In particular, and as discussed below, we seek to examine whether decisions to recall loaned securities in connection with shareholder votes might be more timely and better informed. We also seek to examine whether increased disclosure of the votes cast by institutional securities lenders might improve the transparency of the voting process.

1. Background

Many institutions with investment portfolios of securities—such as insurance companies, pension funds, mutual funds, and college endowments—engage in securities lending to earn additional income on securities that would otherwise be sitting idle in their portfolios. When an institution lends out its portfolio securities, all incidents of ownership relating to the loaned securities, including voting rights, generally transfer to the borrower for the duration of the loan.[92] Accordingly, if the lender wants, or is obligated, to vote the loaned securities, the lender must terminate the loan and recall the loaned securities prior to the record date.[93]

2. Lack of Advance Notice of Meeting Agenda

a. Background

Some institutional securities lenders have proxy voting policies that require the lender, in the event of a material vote, to get back the loaned securities in order to vote the proxies.[94] While issuers are required to provide information in the proxy statement

[91] *See* note 49, above.

[92] *See, e.g.,* Thomas P. Lemke *et al., Regulation of Investment Companies* at 8.02[1][2][vi][A] (2006) ("legal title to the [loaned] securities (along with voting rights and rights to dividends and distributions) passes to the borrower for the term of the loan; when the securities are returned, the fund regains title"). *See also* Master Securities Loan Agreement, note 72, above, at 7.1 (generally the borrower receives all the incidents of ownership of the borrowed securities while loan is open).

[93] It is not typically feasible for the lender to retain proxy voting rights while the loan is open because the borrower typically transfers the loaned securities (for example, in a short sale), and the eventual transferee needs full right and title to the acquired securities.

[94] For example, the Commission staff has agreed not to object if voting rights pass with the lending of securities provided that if the management of the lending fund has knowledge that a material event will occur with respect to a security on loan, the fund directors would be obligated to recall such loan in time to vote the proxies. *See, e.g.,* State Street Bank & Trust Company, SEC Staff No-Action Letter (Sept. 29, 1972).

about the matters to be voted on at a shareholder meeting, the proxy statement typically is not mailed out until after the record date. Therefore, those institutional lenders that desire, or are obligated, to vote proxies with respect to securities on loan in the event of a material vote face the challenge of learning what matters will be voted on at shareholder meetings sufficiently in advance of the record date so that the lenders can determine whether they want to get the loaned securities back before the record date.

We understand that some institutional securities lenders may try to obtain timely information about meeting agendas through a variety of informal means, including media reports. We are also told, however, that this informal process is not an effective substitute for a formal process that would alert securities lenders to the matters to be voted on at shareholder meetings in time to terminate the loan and receive the loaned securities. We understand that, in some instances, securities lenders learn of material votes too late to recall the loans to vote the proxies.[95]

b. Potential Regulatory Responses

In considering possible solutions, we note that, under Section 401.02 of the NYSE Listed Company Manual, NYSE-listed issuers must provide the exchange with notice of the record and meeting dates for shareholder meetings at least ten days prior to the record date for the meeting, unless it is not possible to do so. That notice must describe the matters to be voted upon at the meeting, unless it is accompanied by printed material being sent to shareholders which describes those matters. We understand, however, that this formal notice is not disseminated to the public and may not contain specific descriptions of all matters to be voted on at the meeting.

Consequently, one possible regulatory response is to ask the NYSE to revise its rules to require public dissemination of a notice, in advance of the record date, that contains information about the record and meeting dates as well as specific descriptions of all matters to be voted upon. Other SROs could also be asked to adopt similar rules. An alternative possibility is a requirement for all issuers subject to our proxy rules to disclose the agenda by public means, such as by filing a report on Form 8–K (or as an alternative to such a filing requirement, permitting the issuance of a press release or a posting on a corporate Web site).

In identifying these alternatives, we are mindful that it can be difficult for issuers to disclose complete meeting agendas in advance of the record date because the agenda may not be established at that time for a variety of reasons, including board consideration of initiatives proposed by management and Commission staff review of no-action requests regarding Rule 14a–8 shareholder proposals.

c. Request for Comment

- Should the Commission propose a rule to require issuers to disclose publicly the meeting agenda sufficiently in advance of the record date to permit securities lenders to determine whether any of the matters warrant a termination of the loan so that they may vote the proxies? If so, how many days would constitute sufficient notice to the public?
- What are the advantages and disadvantages, practical and as a matter of policy, to requiring issuers to provide this advance notice to the public? For instance, would the issuer know, sufficiently in advance, all of the items to be on the agenda, particularly shareholder proposals which may be the subject of a request for no-action relief being considered by the Commission's staff?[96] How could such a requirement provide notice of contested matters and other non-management proposals to be considered at the meeting? Could we address concerns by allowing issuers to publish an agenda that is "subject to change"? If so, should we limit such changes to shareholder proposals for which the issuer is seeking no-action relief? How often does uncertainty about a meeting agenda preclude issuers from disclosing the agenda in sufficient time for shareholders to recall loans before the record date?
- Would a mechanism that alerts lending shareholders to meeting agendas well in advance of record dates have positive and desirable effects on the proxy solicitation system such that the Commission should encourage and facilitate this? Would such a mechanism increase the number of lenders recalling loans, and result in greater loan instability, with adverse effects on the capital markets? If there are competing interests, which should prevail, and why?
- How could an advance notice requirement be effected? Should the Commission propose rules applicable to all issuers subject to the proxy rules? Or, should the SROs amend or adopt listing standards requiring their listed issuers to provide advance notice to the public of record and meeting dates and specific descriptions of all matters to be voted on at the shareholder meeting?
- If we required advance notice, through what medium should such notice to shareholders be made? Should issuers be required to issue a press release or make a company Web site posting in addition to filing a notice with the Commission? Would such notice be sufficient for shareholders?
- We also request data regarding the recall of loaned securities by institutional shareholder lenders in order to vote the shares. Please include information regarding the circumstances in which the recalls did and did not occur, and whether the shares were ultimately voted.

3. Disclosure of Voting by Funds

a. Background

Management investment companies registered under the Investment Company Act (collectively, "funds") are required to disclose on Form N–PX how they vote proxies relating to portfolio securities.[97] In adopting this requirement in 2003, the Commission stated that "[i]nvestors in mutual funds have a fundamental right to know how the fund casts proxy votes on shareholders' behalf."[98] Indeed, the Commission required funds to disclose whether they cast their vote for or against management, in an effort to benefit fund shareholders by improving transparency and enabling them to monitor whether their funds approved or disapproved of the governance of portfolio companies.[99]

As noted above, when a fund lends its portfolio securities, all incidents of ownership relating to the loaned securities, including proxy voting rights, generally transfer to the borrower for the duration of the loan.[100] Accordingly, the fund generally loses its ability to vote the proxies of such securities, unless and until the loan is terminated and the securities are returned to the lender prior to the record date in question.

Currently, Form N–PX requires disclosure of proxy voting information "for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the report and with respect to which

[95] *See* Roundtable Transcript, note 79, above.

[96] When an issuer seeks to exclude a shareholder proposal submitted pursuant to Rule 14a–8, it must file its reasons with the Commission. 17 CFR 240.14a–8(j).

[97] *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Release No. IC–25932 (Jan. 31, 2003) [68 FR 6564].

[98] *Id.* at 6566.

[99] *Id.* at 6565.

[100] *See* note 92, above.

the registrant was entitled to vote." [101] However, Form N–PX does not require disclosure of the number of shares for which proxies were voted, nor does the Form require disclosure with respect to portfolio securities on loan when, as is generally the case, the fund is not entitled to vote proxies relating to those securities. Thus, for example, if a fund lends out 99% of its portfolio holdings of XYZ Corporation and therefore votes only 1% of its holdings of XYZ, Form N–PX would disclose that the fund voted proxies with respect to shares of XYZ, but would not also disclose that the fund did not vote 99% of its holdings of XYZ because they were on loan.

b. Potential Regulatory Responses

We seek to examine whether Form N–PX should be amended to require disclosure of the actual number of votes cast by funds.

c. Request for Comment

- Should Form N–PX require disclosure of the actual number of shares voted? Should Form N–PX require disclosure of the number of portfolio securities for which a fund did not vote proxies because the securities were on loan or for other reasons?
- What would be the costs to funds of disclosing the actual number of proxy votes? What would be the costs to funds of disclosing the number of portfolio securities for which a fund did not vote proxies?

D. Proxy Distribution Fees

1. Background

One of the most persistent concerns that has been expressed to the Commission's staff, particularly by issuers, involves the structure and size of fees charged for the distribution of proxy materials to beneficial owners.

a. Current Fee Schedules

Pursuant to Exchange Act Rules 14b–1 and 14b–2, respectively, broker-dealers and banks must distribute certain materials received from an issuer or other soliciting party to their customers who are beneficial owners of securities of that issuer. These materials include proxy statements, information statements, annual reports, proxy cards, and other proxy soliciting materials.[102] A broker-dealer or bank does not need to satisfy this obligation, however, unless the issuer provides "assurance of reimbursement of the broker's or dealer's reasonable expenses, both direct and indirect," that the broker-dealer will incur in distributing the materials to its customers.[103]

In adopting these rules, we did not determine what constituted "reasonable expenses" that were eligible for reimbursement. Rather, the SROs submitted rule filings with us pursuant to Section 19(b) of the Exchange Act to establish these amounts.[104] Because SROs represent both issuers and broker-dealers, we believed that SROs would be best positioned to "make a fair evaluation and allocation" of the costs associated with the distribution of shareholder materials.[105] Accordingly, SRO-adopted rules, approved by the Commission, establish the maximum amount that an SRO member may receive for soliciting proxies from, and distributing other issuer materials to, beneficial owners on behalf of issuers.[106]

Since 1937, the New York Stock Exchange has required issuers, as a matter of policy, to reimburse its members for out of pocket costs of forwarding proxy materials.[107] Reimbursement rates were formally established by rule in 1952, and have been revised periodically since then.[108] Today, NYSE Rules 451 and 465 establish the fee structure for which a NYSE member organization may be reimbursed [109] for expenses incurred in connection with the forwarding of proxy materials, annual reports, and other materials to beneficial owners.[110] The NYSE initially proposed this fee structure as part of a one-year pilot program, which elicited a number of comments before the Commission approved the pilot program in 1997.[111] The pilot program was extended several times, during which time the NYSE participated in the Proxy Voting Review Committee, which was established to review the pilot fee structure.[112] In 2002, the NYSE proposed to implement the fee structure on a permanent basis, with some changes, in light of the recommendations of the Proxy Voting Review Committee.[113] Some commentators raised concerns about the amount of the fees and the absence of competition that might help determine the appropriate level for those fees.[114] In approving the fee structure on a permanent basis, we stated that we expected the NYSE to monitor the fees to confirm that they continued to relate to "reasonable expenses." [115]

Currently, the rates set by the NYSE for the forwarding of an issuer's proxy materials include: [116]

[101] *See* Item 1 to Form N–PX. Form N–PX requires disclosure of the following: The name of the issuer of the portfolio security; the exchange ticker symbol of the portfolio security; the Council on Uniform Securities Identification Procedures (CUSIP) number for the portfolio security; the shareholder meeting date; a brief identification of the matter voted on; whether the matter was proposed by the issuer or by a security holder; whether the fund cast its vote on the matter; how the fund cast its vote (*e.g.,* for or against proposal, or abstain; for or withhold regarding election of directors); and whether the fund cast its vote for or against management.

[102] 17 CFR 240.14b–1(b); 17 CFR 240.14b–2(b).

[103] 17 CFR 240.14b–1(c)(2); 17 CFR 240.14b–2(c)(2).

[104] 15 U.S.C. 78s(b). *See, e.g.,* Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change Relating to a One-Year Pilot Program for Transmission of Proxy and Other Shareholder Communication Material, Release No. 34–38406 (Mar. 14, 1997) [62 FR 13922]. We note that, in approving a rule filing, we must find that such filing is consistent with the Exchange Act. For example, Section 6(b)(4) of the Exchange Act requires that the rules of an exchange "provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities." 15 U.S.C. 78f(b)(4).

[105] *See* Release No. 34–38406, note 104, above.

[106] *See* text accompanying notes 116 to 120, below.

[107] *See* Report and Recommendations of the Proxy Working Group to the New York Stock Exchange ("Proxy Working Group Report"), June 5, 2006, *available at http://www.nyse.com/pdfs/REVISED_NYSE_Report_6_5_06.pdf,* at 23.

[108] *Id.*

[109] It should be noted that the NYSE fee schedule under Rule 451 for expenses incurred in connection with proxy solicitations is the same as the fee schedule for expenses incurred in mailing interim reports or other material pursuant to Rule 465. For purposes of this release, references to fees will cite to NYSE Rule 465. Pursuant to Rule 465, member organizations are entitled to receive reimbursement for all out of pocket expenses, including clerical expenses as well as actual costs, including postage costs, the cost of envelopes, and communication expenses incurred in receiving voting returns either electronically or telephonically. *See* NYSE Rule 465(2) and Supplementary Material to Rule 465.20.

[110] The vast majority of firms that distribute issuer material to beneficial owners are reimbursed at the NYSE fee schedule rates because most of the brokerage firms are NYSE members or members of other exchanges that have rules similar to the NYSE's rules.

[111] *See* Release No. 34–38406, note 104, above.

[112] *See* Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Its Rules Regarding the Transmission of Proxy and Other Shareholder Communication Material and the Proxy Reimbursement Guidelines Set Forth In Those Rules, and Requesting Permanent Approval of the Amended Proxy Reimbursement Guidelines, Release No. 34–45644 (Mar. 25, 2002) [67 FR 15440] ("NYSE Fee Structure Order").

[113] *Id.*

[114] *Id. See also* Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change Relating to the Reimbursement of Member Organizations for Costs Incurred in the Transmission of Proxy and Other Shareholder Communication Material, Release No. 34–41177 (Mar. 16, 1999) [64 FR 14294].

[115] *See* NYSE Fee Structure Order, note 112, above.

[116] *See* NYSE Supplementary Material to Rule 465.20.

• A "Base Mailing Fee" of $0.40 for each beneficial owner account when there is not an opposing proxy (the "Base Mailing Fee"). This fee applies for each set of proxy materials, regardless of whether the materials have been mailed or the mailing has been suppressed or eliminated.

• An "Incentive Fee" of $0.25 per beneficial owner account for issuers whose securities are held by many beneficial owners and $0.50 per account for issuers with few beneficial owners.[117] This fee, which is in addition to the Base Mailing Fee, applies when the need to mail materials in paper format has been eliminated, for instance, by eliminating duplicative mailings to multiple accounts at the same address.[118]

• A "Nominee Coordination Fee" of $20 per "nominee"—*i.e.,* securities intermediaries that are either registered holders or identified on the DTC securities position listing—which is paid to a proxy service provider that coordinates the mailings for multiple securities intermediaries.

• An additional "Nominee Coordination Fee" of $0.05 per beneficial owner account for issuers whose securities are held by many beneficial owners [119] and $0.10 per account for issuers with few beneficial owners.[120]

While a member organization, such as a securities intermediary, may seek reimbursement for less than the approved rates, it may not seek reimbursement for an amount higher than the approved rates listed in Rule 465, or for items or services not enumerated in Rule 465, "without the prior notification to and consent of the person soliciting proxies or the issuer." [121]

When the fees were approved in 2002, we expected the NYSE "to continue its ongoing review of the proxy fee process, including considering alternatives to SRO standards that would provide a more efficient, competitive, and fair process." [122] We also indicated that market participants should consider ways in which market forces could determine reasonable rates of reimbursement, rather than have these rates be set by the NYSE under its rules.[123]

In 2006, the Proxy Working Group considered the NYSE's current fee structure and indicated that Rule 465's fees "may be expensive to issuers but generally result[] in shareholders receiving and being able to vote proxies in a timely manner. This is an important benefit of the current system." [124] The Proxy Working Group also noted, however, that "issuers and shareholders deserve periodic confirmation that the system is performing as cost-effectively, efficiently and accurately as possible, with the proper level of responsibility and accountability in the system." [125] The Proxy Working Group also recommended that the NYSE should "continue to explore alternative systems * * * such that a competitive system, with fees set by the free market, could eventually succeed the current system." [126] The Proxy Working Group recommended that the NYSE engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid under Rule 465 and to study the performance of the proxy service provider that currently has the largest market share and the business process by which the distribution of proxies occurs. To date, this review has not been done. Subsequently, the Proxy Working Group's Cost and Pricing Subcommittee considered the changes brought about through the notice and access model and decided that the notice and access fees were not covered under current NYSE fee rules and concluded that they should allow participants to negotiate their own fees.[127]

After the NYSE fee structure for proxy distribution was established on a permanent basis in 2002, other SROs adopted similar rules. For example, the NYSE Amex LLC ("Amex") and the Financial Industry Regulatory Authority, Inc. ("FINRA") revised their rules (Amex Rule 576, Amex Section 722 of the Amex Company Guide, and NASD IM–2260, respectively) to adopt similar provisions.[128]

b. Notice and Access Model

Neither the NYSE nor any other SRO has established maximum fees that member firms may charge issuers for deliveries of proxy materials using the notice and access method. The majority of broker-dealers have contracts with one proxy service provider to distribute proxies to beneficial owners.[129] If an issuer elects the "notice-only" delivery option for any or all accounts, that proxy service provider currently charges an "Incremental Fee," ranging from $0.05 to $0.25 per account for positions

[117] The Incentive Fee is $0.25 for each account for issuers whose shares are held in at least 200,000 nominee accounts, and $.50 for each account for issuers whose shares are held in fewer than 200,000 accounts. According to the NYSE, the cost to service large issuers, *i.e.,* issuers whose shares are held in at least 200,000 nominee accounts, is less than the cost to service small issuers because of economies of scale, which justifies a smaller Incentive Fee for large issuers. *See* NYSE Fee Structure Order, note 112, above.

[118] NYSE Rule 465 includes the following examples as being eligible for the Incentive Fee: "multiple proxy ballots or forms in one envelope with one set of material mailed to the same household, by distributing multiple proxy ballots or forms electronically thereby reducing the sets of material mailed, or by distributing some or all material electronically."

[119] The per-account Nominee Coordination Fee is $0.05 for each account for each issuer's securities for issuers whose shares are held in at least 200,000 beneficial owner accounts held by nominees, and $.10 for each account for each issuer's securities for issuers whose shares are held in fewer than 200,000 beneficial owner accounts held by nominees. *See* NYSE Fee Structure Order, note 112, above. According to the NYSE, as with Incentive Fees, the cost to service large issuers is less than the cost to service small issuers because of economies of scale, which justifies a smaller Nominee Coordination Fee per account for large issuers. *Id.*

[120] For example, if an issuer's securities are held in 10,000 beneficial owner accounts holding in street name, and those accounts are divided among ten securities intermediaries, the fees discussed above would be assessed as follows:

Base Mailing Fee of 10,000 accounts × $0.40 per account, or $4,000;

Incentive Fee of 5,000 accounts suppressed × $0.50 per account, or $2,500 (assuming 50% of the accounts are eligible for the incentive fee);

Nominee Coordination Fee of 10 securities intermediaries × $20 per intermediary, or $200; and

Additional Nominee Coordination Fee of 10,000 accounts × $0.10 per account, or $1,000.

[121] *See* NYSE Supplementary Material to Rule 465.23.

[122] *See* NYSE Fee Structure Order, note 112, above. In the NYSE Order, we also stated that we expected NYSE to "periodically review these fees to ensure they are related to 'reasonable expenses * * * in accordance with the [Exchange] Act, and propose changes where appropriate." *Id.*

[123] *Id.*

[124] Proxy Working Group Report, note 107, above, at 5.

[125] *Id.,* at 26.

[126] *Id.,* at 29.

[127] *See* August 27, 2007 Addendum to the Report and Recommendations of the Proxy Working Group to the New York Stock Exchange dated June 5, 2006 ("Proxy Working Group Addendum"), *available at http://www.nyse.com/pdfs/PWGAddendumfinal.pdf.*

[128] *See* Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the American Stock Exchange LLC Amending Exchange Rules 576 and 585, and Sections 722 and 725 of the Amex Company Guide, Release No. 34–46146 (June 28, 2002) [67 FR 44902] and Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to an Amendment to NASD Interpretive Material 2260, Release No. 34–47392 (Feb. 21, 2003) [68 FR 9730]. NASD Rule 2260 and NASD IM–2260 were recently renumbered as FINRA Rule 2251 in the Consolidated FINRA Rulebook. *See* Order Granting Approval of Proposed Rule Change to Adopt FINRA Rule 2251 (Forwarding of Proxy and Other Issuer-Related Materials) in the Consolidated FINRA Rulebook, Release No. 34–61052 (Nov. 23, 2009) [74 FR 62857].

[129] Broadridge, as the service provider for most U.S. broker-dealers holding customer accounts, distributes the vast majority of proxy mailings to beneficial owners. *See* Proxy Working Group Report, note 107, above, at 24 ("ADP [(now Broadridge) is] the agent for almost all banks and brokerage houses.").

in excess of 6,000,[130] in addition to the other fees permitted to be charged under NYSE Rule 465. This Incremental Fee is charged to all accounts, even if the issuer has elected to continue "full set" delivery to some accounts. Several issuers have expressed concerns about these fees associated with the notice and access model.

c. Current Practice Regarding Fees Charged

As noted above, broker-dealers generally outsource their delivery obligations to proxy service providers.[131] The proxy service provider enters into a contract with the broker-dealer and acts as a billing and collection agent for that broker-dealer. As such, the proxy service provider bills issuers on behalf of the broker-dealer with which it has contracted, collects the fees from the issuer to which the broker-dealer is entitled pursuant to SRO rules, and pays to the broker-dealer any difference between the fee that the broker-dealer is entitled to collect and the amount that the broker-dealer has agreed to pay the proxy service provider for its services.[132]

It is our understanding that Broadridge currently bills issuers, on behalf of its broker-dealer clients, the maximum fees allowed by NYSE Rule 465.[133] However, we understand that the fees that Broadridge charges its large broker-dealer clients for its services sometimes are less than the maximum NYSE fees charged to issuers on the broker-dealers' behalf, resulting in funds being remitted from Broadridge to a subset of its broker-dealer clients. This practice raises the question as to whether the fees in the NYSE schedule currently reflect "reasonable reimbursement." While the issuer pays the proxy distribution fees, the issuer has little or no control over the process by which the proxy service provider is selected, the terms of the contract between the broker-dealer and the proxy service provider, or the fees that are incurred through the proxy distribution process.

Several other issues concerning the appropriateness of fees have also been raised in recent years. For example, it is our understanding that, once a paper mailing is suppressed, the securities intermediary, or its agent, collects the Incentive Fee, not only for the year in which the shareholder makes that election, but also for every subsequent year, even though the continuing role of the securities intermediary, or its agent, in eliminating these paper mailings is limited to keeping track of the shareholder's election.[134] Further, it is our understanding that, with respect to certain managed accounts, where hundreds or thousands of beneficial owners may delegate their voting decisions to a single investment manager, the Base Mailing Fee and the Incentive Fee are assessed for all accounts, even though only one set of proxy materials is transmitted to the investment manager.[135]

In summary, many issues have been raised about fees, focusing mostly on whether the current fee structure for delivering proxy materials to beneficial owners reflects reasonable rates of reimbursement.

2. Potential Regulatory Responses

We have previously recognized the potential benefits of allowing the marketplace, rather than SRO rules and guidelines, to determine reasonable rates of reimbursement for the distribution of proxy materials. As noted above, at the time of adoption of the current fee structure, we did not expect that the discussion of reasonable rates of reimbursement would end. Rather, we noted that market forces should ultimately determine competitive and reasonable rates of reimbursement, and urged the NYSE to identify ways to achieve this goal, consistent with the continued protection of shareholder voting rights in a competitive marketplace for proxy distribution.[136] While the Proxy Working Group did suggest ways to re-evaluate the NYSE's current fee structure, such as conducting "cost studies, commission audits and surveys of various constituencies involved,"[137] to date those suggestions have not been implemented. A proxy distribution process that fosters competition could give issuers, which are responsible for reimbursing only reasonable proxy distribution costs, more control over that process and remove the Commission and SROs from the business of setting rates. However, we understand that, without a competitive market, there may be a continued need for regulated fees.

In addition, we recognize the importance of maintaining a proxy distribution system that is efficient, reliable, and accurate. We note that various groups have previously attested to the efficiency, reliability, and accuracy of the current proxy distribution system.[138] However, given developments in the securities market overall and proxy solicitation rules, such as the notice and access model, it appears to be an appropriate time for SROs to review their existing fee schedules to determine whether they continue to be reasonably related to the actual costs of proxy solicitation.

One alternative that has been suggested by a commentator is the creation of a central data aggregator that is given the right to collect beneficial owner information from securities intermediaries, but is required to provide that information to any agent designated by the issuer.[139] The aggregator would be entitled to structured compensation for its activities. This could create competition among service providers for the distribution of the proxy materials by making the beneficial owner

[130] The Incremental Fee for 1 to 6,000 positions is $1,500. Above 6,000 positions, the fee is charged on a per-account basis, and varies according to the number of positions. As such, the Incremental Fee ranges from $.25 per account for 6,001 to 10,000 positions to $.05 per account for greater than 500,000 positions. *See* Broadridge Fee Schedule, at *http://www.broadridge.com/notice-and-access/pdfs/Reference_Rev1_31.pdf.*

[131] *See* NYSE Fee Structure Order, note 112, above. According to the NYSE, this shift was attributable to the fact that member firms believed that proxy distribution "was not a core broker-dealer business and that capital could be better used elsewhere." *Id.*

[132] *See* Release No. 34–38406, note 104, above. *See also* Broadridge Form 10–K for the fiscal year ended June 30, 2009, at 4.

[133] *See* Broadridge Fee Schedule, note 130, above.

[134] This Incentive Fee is intended to encourage securities intermediaries to reduce proxy distribution costs on behalf of issuers because intermediaries otherwise may have no motivation to reduce an issuer's forwarding costs. *See* SIFMA, Report on the Shareholder Communications Process with Street Name Holders, and the NOBO–OBO Mechanism (June 10, 2010) ("SIFMA Report"), at 14 (describing categories of ongoing costs of maintaining current e-mail addresses and related databases and systems), available in the public comment file to this release.

[135] *See* letter from Thomas L. Montrone of The Securities Transfer Association to Chairman Mary Schapiro, dated June 2, 2010 (stating that "We believe that many issuers are being assessed unreasonable fees under Rule 465 related to share ownership in separate managed accounts ("SMAs") in which the investor has delegated responsibility for management of the account and is not being provided with any proxy materials"), available in the public comment file to this release.

[136] *See* NYSE Fee Structure Order, note 112, above.

[137] *See* Proxy Working Group Report, note 107, above, at 26–27.

[138] *See, e.g.,* letter from Donald D. Kittell, Securities Industry Association, to Nancy M. Morris, Secretary, Commission, dated Feb. 13, 2006 ("The current system for delivering proxies to 80 percent of shareholders—those holding in 'street name'—has proven to be very efficient and cost-effective.") available in the public comment file to this release. *See also* Proxy Working Group Report, note 107, above, at 25 (citing to letter from Richard H. Koppes, Facilitator, Proxy Voting Review Committee, to Sharon Lawson, Senior Special Counsel, Commission, dated Feb. 28, 2002).

[139] *See* Shareholder Communications Coalition, *Public Issuer Proxy Voting: Empowering Individual Investors and Encouraging Open Shareholder Communications* (Aug. 4, 2009) ("SCC Discussion Draft"), at 6, available in the public comment file to this release.

information available to all service providers, allowing them to compete in providing services to forward proxy materials. This would also place the choice of proxy service provider in the hands of the entity that must pay for the distribution—the issuer—rather than the securities intermediary, which has no incentive to reduce costs.

Some of the other potential regulatory responses discussed in this release also would affect the current system of distributing proxy materials and, therefore, the process of setting proxy distribution fees. For instance, adopting a system under which securities intermediaries grant proxies to underlying beneficial owners (as discussed in Section III.A) would permit issuers to negotiate fees and services with proxy service providers because the issuers would be directly soliciting proxies from those beneficial owners.

3. Request for Comment

- Does the current fee/rebate structure reflect reasonable expenses? Why or why not? If not, how should these rates be revised?
- Should the fee structure allow for reimbursement of the Incentive Fee on an ongoing basis once the paper mailings have already been eliminated?
- How are proxy distribution fees billed with respect to separately managed accounts? Should certain kinds of accounts, such as separately managed accounts, where multiple beneficial owners may delegate their voting decisions to a single investment manager, be eligible for different treatment under the current fee structure?
- Are separately managed accounts different from "wrap" accounts for which issuers may not be charged suppression fees for providing proxy communication services to holders of WRAP accounts? [140]
- Does the current fee structure discourage issuers from communicating with beneficial owners beyond delivery of the required proxy materials?
- Should there be an independent third-party audit of the current fee structure, as recommended by the Proxy Working Group?
- Do broker-dealers using a proxy service provider incur costs that justify rebates from the proxy service provider? If so, what are the costs, can they be quantified, and are they commensurate with the payments received from the proxy service provider? Do these costs exist only for larger broker-dealers or for broker-dealers of all sizes? Should the current rebates between Broadridge and larger broker-dealers be permitted under the current fee structure? Should current contractual arrangements between proxy service providers and their clients affect the determination of whether fees are fair and reasonable?
- Currently, SRO rules do not set rates for reimbursement of expenses associated with the notice and access model. In the absence of SRO rules, on what basis do market participants currently determine whether the reimbursement of expenses associated with the notice and access model is, in fact, reasonable?
- Should the current fee structure that is set forth in SRO rules be revised to include fees for notice and access delivery? If so, what fees for the notice and access model might constitute "reasonable reimbursement?"
- Does the current proxy distribution system—in which the proxy service provider is selected by a broker-dealer but paid by the issuer—create a lack of incentives to reduce costs for issuers? Should the issuer have more control over the selection and payment of the proxy service provider, and if so, what alternatives to the current system would facilitate this? What are the potential benefits and drawbacks of such alternatives?
- What factors are currently affecting the level of competition in the market for proxy service providers and their fees? What principles should guide the Commission's current consideration of competition among proxy service providers? Would multiple competing service providers affect the quality of service?
- What steps would be necessary to enable prices to be based on competitive market forces? What are the potential benefits and drawbacks of moving to a system where prices are determined by competitive market forces? What effect, if any, would this have in terms of accuracy, accountability, reliability, cost, and efficiency of the proxy distribution system? Would a market-based model increase or decrease costs for issuers? Would cost increases or decreases be more likely for small to midsize issuers?
- If issuers were able to solicit proxies directly from beneficial owners, what effect would that likely have on proxy distribution costs? Would costs be reduced through the introduction of competition and better alignment of economic incentives? Or, could the loss of economies of scale increase costs? Would each issuer likely negotiate fees on its own with a proxy service provider? Would the impact be different for large, medium, or small issuers?
- What are the practical and legal implications of deregulating fees in light of the existing contracts between proxy service providers and broker-dealers? For example, would these contracts need to be re-negotiated?
- What are the potential merits and drawbacks of having a central data aggregator collect beneficial owner information from securities intermediaries? How would reimbursement to the aggregator, as the distributor of information, be determined?
- Would changes to the OBO/NOBO mechanism, or the creation of a central data aggregator, encourage competition in the proxy distribution sector? Would competition increase or lower costs? Would competition increase or decrease accountability?
- A number of investors have complained about the services of proxy service providers (and transfer agents performing similar functions). How are investors' interests addressed, if at all, in the selection of proxy service providers? Are the interests of investors in this process given adequate weight?

IV. Communications and Shareholder Participation

We first examine a number of concerns relating to the ability of issuers to communicate with shareholders, the level of shareholder participation in the proxy voting process, and the ability of investors to obtain and evaluate information pertinent to voting decisions. Because of the importance of shareholder voting, as discussed above, we seek additional information about ways in which issuer communications with shareholders, shareholder participation and shareholder use of information might be improved.

A. Issuer Communications With Shareholders

1. Background

The first area of concern that we address arises out of the practice of holding securities in street name—that is, interposing securities intermediaries between issuers and the beneficial owners of their securities. This practice developed in order to facilitate the prompt and accurate processing of an increasingly large volume of securities transactions.[141] The efficiency of the

[140] It is our understanding that a wrap account is a certain type of account that is managed by an outside investment manager.

[141] For a history of the U.S. shareholder system, see Alan L. Beller & Janet L. Fisher, The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting (February 2010), *available at http://www.cii.org/UserFiles/file/*

clearance and settlement system in the U.S. is due in large part to the ability to "net" transactions, whereby contracts to buy or sell securities between broker-dealers are replaced with net obligations to a registered clearing agency, the National Securities Clearing Corporation ("NSCC"). To make netting possible, securities must be held in fungible bulk at DTC.

There is broad consensus [142] that the enormous volume of transactions cleared and settled in the U.S., which currently involve transactions valued at over $1.48 quadrillion annually,[143] requires a centralized netting facility (*i.e.,* NSCC) and a depository (*i.e.,* DTC) that facilitates book-entry settlement of securities transactions. It is our understanding that this approach to clearance and settlement has produced significant efficiencies, lower costs, and risk management advantages. At the same time, however, the practice of holding securities in fungible bulk has made it more difficult for issuers to identify their beneficial owners and to communicate directly with them.

In light of recent developments in corporate governance, including the elimination of the broker discretionary vote on uncontested elections of directors, commentators have claimed a greater need for issuers to be able to communicate with their shareholders.[144] These commentators have argued that the number of contested issues in shareholder meetings has increased, that voting outcomes are under more pressure, and that, as a result, certain changes should be made to our rules in order to facilitate communications by issuers with their beneficial owners.[145] More broadly, commentators have questioned whether the current system of share ownership and the Commission's communications and proxy rules adequately serve the needs of investors and issuers.[146]

The history of our efforts to address the impediments to communication associated with our securities ownership system goes back more than three decades.

In 1976, we reported to Congress on the effects of the practice of holding securities in street name.[147] While we concluded that the practice of registering securities in nominee (that is, DTC or a securities intermediary) and street name was consistent with the purposes of the Exchange Act, we recognized that issuers were experiencing difficulties in communicating with their shareholders who hold securities in nominee and street name. In an effort to enhance communication, we revised the proxy rules to require issuers, as more fully described above, to do the following:

- Inquire of securities intermediaries whether other persons beneficially owned the securities they held of record; and
- Supply securities intermediaries with a sufficient number of sets of proxy materials to forward to beneficial owners.[148]

To promote direct communication between issuers and their beneficial owners, we adopted rules in 1983, effective in 1985, to require broker-dealers and banks to provide issuers, at their request, with lists of the names and addresses of beneficial owners who did not object to having such information provided to issuers.[149] These owners are often referred to as "non-objecting beneficial owners" or "NOBOs." When a beneficial owner objects to disclosure of its name and address to the issuer—often referred to as "objecting beneficial owners" or "OBOs"—the beneficial owner may be contacted only by the securities intermediary (or the intermediary's agent) with the customer relationship with the beneficial owner.[150] According to one estimate, 70% to 80% of all public issuers' shares are held in street name, and 75% of those shares, or 52% to 60% of all shares, are held by OBOs.[151] It is our understanding that some types of large institutional investors, such as mutual funds [152] and retirement plans, often choose OBO status.[153]

We understand that there are concerns about the cost and efficiency of the current system of communications between issuers and investors, including the following: [154]

CII%20White%20Paper%20-%20The%20OBO–NOBO%20Distinction%20in%20Beneficial%20Ownership%20February%202010.pdf, at 8–10. This report (the "CII OBO/NOBO Report") was published by the Council of Institutional Investors.

[142] *See* "Recommendations for Securities Settlement Systems," CFSS/IOSCO Task Force (Nov. 2001) and "Global Clearing and Settlement, A Plan of Action," published by the Group of Thirty ("G–30") (Jan. 30, 2003).

[143] *See http://www.dtcc.com/about/business/statistics.php.*

[144] *See* Proxy Working Group Report, note 107, above, at 22 (discussing comments received with respect to a then-proposed amendment, which was recently adopted, to Rule 452 eliminating broker-dealer voting in the election of directors).

[145] *See, e.g.,* CII OBO/NOBO Report, note 141, above, at 11 ("Recent developments in corporate governance will place more pressure on voting outcomes and increase the need for both companies and shareowners to have an effective and reliable framework for communications."); letter from Shareholder Communications Coalition to Chairman Mary Schapiro (Aug. 4, 2009), *available at http://www.shareholdercoalition.com/SCCLetterto SECChairmanMarySchapiroAug2009.pdf.*

[146] In 2004, the BRT Petition urged the Commission "to conduct a thorough review of the current shareholder communications system." BRT Petition, note 8, above. The petition recommended that "the Commission require brokers and banks to provide issuers with contact information for all beneficial owners and permit the direct mailing of all communications (including proxy materials) to beneficial owners." *Id. See also* Marcel Kahan & Edward B. Rock, *The Hanging Chads of Corporate Voting,* 96 Georgetown Law Journal 1227 (2008); J. Robert Brown Jr., *The Shareholder Communication Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility,* 13 Journal of Corporation Law 683 (1988); David C. Donald, *The Rise and Effects of the Indirect Holding System: How Corporate America Ceded Its Shareholders to Intermediaries* (Sept. 26, 2007), *available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1017206.*

[147] Street Name Study, note 13, above.

[148] Notice of Adoption of Amendments to Rules 14a–3, 14c–3 and 14c–7 under the Exchange Act to Improve the Disclosure in, and the Dissemination of, Annual Reports to Security Holders and to Improve the Dissemination of Annual Reports on Form 10–K or 12–K Filed with the Commission Under the Exchange Act, Release No. 34–11079 (Oct. 31, 1974) [39 FR 40766]. These requirements, which were originally included in Rule 14a–3(d), are currently set forth in Rule 14a–13 [17 CFR 240.14a–13]. Facilitating Shareholder Communications, Release No. 34–22533 (Oct. 15, 1985) [51 FR 44276]. Based in part on the recommendation of the Street Name Study, we adopted additional rules in 1977 facilitating the transmission of proxy materials from issuers to beneficial owners. Requirements for Dissemination of Proxy Information to Beneficial Owners by Issuers and Intermediary Broker-Dealers, Release No. 34–13719 (July 5, 1977) [42 FR 35953].

[149] *See* Facilitating Shareholder Communications Provisions, Release No. 34–20021 (July 28, 1983) [48 FR 35082]. Exchange Act Rule 14a–13(b)(5) enables an issuer to obtain a list of its NOBOs only, which means that broker-dealers and banks must classify their beneficial owners as either objecting or non-objecting beneficial owners, based on the investor's election. A requesting issuer must reimburse the intermediaries for their reasonable expenses in preparing the NOBO list. 17 CFR 240.14a–13(b)(5). The NYSE and other exchanges establish a per-holder fee that member brokers can charge for preparation of the NOBO list. *E.g.,* NYSE Rule 465. Notwithstanding these limitations on the fees, issuers, particularly those with large shareholder bases, have indicated that the cost to obtain such lists can be prohibitive.

[150] *See* 17 CFR 240.14b–1(b)(3)(i). Several commentators have indicated that, in a number of foreign jurisdictions, public issuers have the right to learn the identity of individuals and institutions with voting rights or beneficial owner interests in their shares. *See, e.g.,* BRT Petition, note 8, above; Kahan, note 146, above; Donald, note 146, above.

[151] Proxy Working Group Report at 10–11, note 107, above.

[152] Although mutual funds disclose their securities holdings on Forms N–Q and N–CSR, those disclosures are made as of the end of the quarter, which may not coincide with the record date used to determine shareholders entitled to vote at a meeting.

[153] One recent report states that while "73% of retail shareholders are NOBOs, * * * [m]ost institutional shareholders—about 71%—are OBOs, accounting for about 91% of all institutionally held shares." SIFMA Report, note 134, above, at 7.

[154] Concerns about whether or not to disclose shareholder identities are shared by regulators in several jurisdictions. For example, in Canada,

Continued

• Issuers have indicated to the staff that the majority of their street name securities are held by OBOs through securities intermediaries, making it very difficult to determine the identity and holdings of their investors. Issuers believe that the recent changes in corporate governance, including the move to majority voting of directors, the elimination of broker discretionary voting in uncontested director elections, and a possible drop in retail voting percentages,[155] call for more direct communication between issuers and their shareholders. These communications may include using a proxy solicitor to contact shareholders by telephone. However, an issuer cannot make these direct appeals for shareholders to participate in the issuer's corporate governance if it does not know the identity of those shareholders.

• Issuers also have indicated to the staff that they face considerable expense in communicating with beneficial owners, either OBOs or NOBOs, indirectly through securities intermediaries or their agents. Issuers are required to reimburse securities intermediaries for expenses incurred in forwarding communications to beneficial owners. These expenses include reimbursement for postage, envelopes and communication expenses as well as fees to proxy service providers.[156]

• Some issuers have claimed that the expense of obtaining the list of NOBOs from the securities intermediary or its proxy service provider deters some issuers, particularly widely-held issuers, from using the NOBO list to communicate with beneficial owners.[157] We have also received expressions of concern from broker-dealers about the difficulty of maintaining an accurate NOBO list when a class of securities is actively traded.

• We also have heard that issuers may desire more flexibility to design the proxy materials (*e.g.,* forms of VIFs, packaging of materials, etc.) that are sent to beneficial owners. Some issuers believe that the current uniform appearance of proxy materials used by some of the proxy service providers may lead to reduced interest in the materials by beneficial owners. Other commentators have suggested that VIFs do not sufficiently inform shareholders as to how their shares will be voted if they do not provide instructions on all the matters included on the VIFs.[158]

• Some issuers also have expressed concerns regarding potential quality control problems that have arisen, from time to time, with the services provided by proxy service providers. Similarly, retail investors have complained to our Office of Investor Education and Advocacy, from time to time, that proxy materials have been delivered late. To the extent that delivery of proxy materials is delayed, the utility of issuer-investor communication through the proxy process is impaired.

2. Potential Regulatory Responses

Many issuers, securities intermediaries and commentators believe that there can be more efficient and cost-effective ways for issuers to communicate directly with their shareholders. Some commentators have advocated for significant changes. The 2004 Business Roundtable rulemaking petition ("BRT Petition")[159] recommended that the Commission enable issuers to communicate directly with their beneficial owners by requiring broker-dealers and banks to execute an omnibus proxy in favor of their underlying beneficial owners and by eliminating the ability of beneficial owners to object to the disclosure of their identities to issuers. The BRT Petition argued that eliminating objecting beneficial owner status would create a more efficient proxy system by allowing issuers to bypass securities intermediaries and their agents in forwarding proxy materials and by simplifying the voting and tabulation process.

In 2009, the Shareholder Communications Coalition[160] filed a letter supporting the BRT Petition and providing more specific recommendations on how to implement a system that eliminates objecting beneficial owner status and grants the right to vote directly to the beneficial owners through an omnibus proxy.[161] This proposed system would separate the functions of beneficial owner data aggregation and proxy communications distribution, thereby making beneficial owner data available to the issuer's (and not the securities intermediary's) agent. The system would identify all beneficial owners except those that elect to remain anonymous by registering shares in a nominee account.[162]

Others advocate less comprehensive change and encourage adoption of an approach in which an issuer would be entitled to a list of all beneficial owners, but only as of the record date for a particular meeting.[163] In such a system (an "annual NOBO" system), objecting beneficial owners would not be able to shield their identity for purposes of a shareholder meeting. At any other time during the year, objecting beneficial owner information would not be available to the issuer or any other party. An annual NOBO system would enable issuers to communicate directly with all of their shareholders, both registered and beneficial owners, for purposes of a shareholder meeting, while minimizing the possibility that the investor information will be used for purposes other than proxy solicitation,

companies are under no obligation to send proxy materials to shareholders who do not disclose their underlying identity. *See* OECD Survey, note 90, above. In the United Kingdom, companies have the right to ask any person whom the company knows or has reasonable cause to believe has an interest in its shares to declare that interest. UK Companies Act 2006—Section 793: Notice by company requiring information about interests in its shares, *available at* (*http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en_45*) The failure to do so may enable the company to apply for a court order directing that the shares in question be subject to certain restrictions involving voting rights, transfers and other limitations. UK Companies Act 2006—Sections 794 and 797. Given that shareholders have the right to dismiss the board at any time in the United Kingdom, companies generally believe it is important that the board know who its shareholders are and pay attention to what they want. Thus, the company should be entitled to know who owns its shares in order to ensure accountability in both directions.

[155] It is unclear whether such a drop has occurred. *See* note 196 and accompanying text, below.

[156] *See* Section III.D, above. *See also* Supplementary Material to NYSE Rules 451 and 465; NYSE Listed Issuer Manual § 402.10(A).

[157] Under current NYSE rules, the issuer is required to pay $0.065 per NOBO name, plus reasonable expenses of the broker-dealer's agent in providing the information. NYSE Rule 465 Supplementary Material, *available at http://nyserules.nyse.com/NYSETools/PlatformViewer.asp?searched=1&selectednode=chp%5F1%5F5%5F13%5F1&CiRestriction=465&manual=%2Fnyse%2Frules%2Fnyse%2Drules%2F;* FINRA Rule 2251 Supplementary Material.

[158] *See* James McRitchie, Request for rulemaking to amend Rule 14a–4(b)(1) under the Securities Exchange Act of 1934 to prohibit conferring discretionary authority to issuers with respect to non-votes on the voter information form or proxy. No. 4–583 (May 15, 2009).

[159] *See* BRT Petition, note 8, above.

[160] The Shareholder Communications Coalition is an umbrella group that represents the views of The Business Roundtable, the Society of Corporate Secretaries and Governance Professionals, the National Investor Relations Institute, and the Securities Transfer Association.

[161] *See* SCC Discussion Draft, note 139, above.

[162] A beneficial owner could continue to remain anonymous by hiring a third party to hold the securities for the beneficial owner. In this circumstance, however, the cost of this agency arrangement would be borne by the beneficial owner.

[163] The Altman Group, "Practical Solutions to Improve the Proxy Voting System" (Oct. 2009), *available at http://altmangroup.com/pdf/PracticalSolutionTAG.pdf* (identifying this approach as the "ABO" or "all beneficial owners"system). We use the term "annual NOBO" because we believe it better reflects the fact that, under the system, an OBO would be treated as if it were a NOBO, but only annually or for specific proxy solicitations.

such as determining an investor's trading strategies.

Others have suggested more gradual change.[164] In order to encourage holding in NOBO rather than OBO status, some have suggested various steps to promote selection of NOBO status, such as educating investors about OBO and NOBO status when they open their accounts or periodically. Other steps may involve the elections made by investors when they open their accounts. While our rules contemplate that investors must object to disclosure of their identities to issuers,[165] neither our rules nor self-regulatory organization ("SRO") rules currently require disclosure of the consequences of choosing OBO or NOBO status, or specify broker-dealer policies or procedures with regard to their clients' choice of OBO or NOBO status. In particular, if a securities intermediary's standard customer agreement includes a default election of OBO status, it could promote a less than fully considered election of OBO status. While several broker-dealers have informed us that they currently default beneficial owners to NOBO status, it has been recommended that the default agreement used by all broker-dealers be NOBO status, or that broker-dealers provide informational materials to their customers prior to allowing the customers to elect OBO status and contact customers who elect OBO status periodically to re-elect their OBO/NOBO status.

In addition, there remains the issue of whether beneficial owners have a privacy right with respect to the disclosure of their ownership positions. We have been informed of a variety of privacy considerations: some investors, particularly institutional investors, select OBO status for competitive reasons, in order to mask their investment strategies; other investors may prefer OBO status in order to minimize the communications (particularly telephone calls) they receive regarding their investments.[166] In either case, however, according to a study by the NYSE, investor preference for OBO status may be cost-sensitive and perhaps even overstated.[167]

3. Request for Comment

As discussed above, we are considering whether regulatory action is needed to make it easier for issuers to communicate with their investors. In particular, we seek comment on whether we should eliminate the OBO/NOBO distinction, thereby making all beneficial owner information available to the issuer, or require broker-dealers to disclose the consequences of choosing OBO or NOBO status, or whether OBO or NOBO status should be the default choice. We also are exploring ways in which issuers can communicate directly with beneficial owners, such as requiring securities intermediaries to transfer proxy voting authority to some or all beneficial owners, so that issuers can solicit proxies directly from such holders. In this regard, we seek comment on the following questions:

- Do our existing rules inappropriately inhibit issuers from effectively communicating with investors? If so, what changes should we make to our rules to improve investor communication? Even if our rules do not inappropriately inhibit issuers from effectively communicating with investors, do the rules significantly raise the cost of communicating? Do any non-Commission rules inappropriately inhibit issuers from effectively communicating with investors? What are the benefits and costs of the various changes proposed by commentators?
- Do investors consider the degree and manner of communication with issuers to be adequate?
- To what extent are proxy materials not being delivered in a timely fashion? Are any changes in our rules or other rules required to improve timeliness of delivery, either with respect to registered or beneficial owners?
- What impact does the uniform appearance of proxy materials such as the VIF have on shareholder participation in proxy voting? Would investors, especially retail investors, be more likely to vote if there was less uniformity in the appearance of proxy materials?
- Is the format and layout of proxy cards and VIFs clear and easy to use from the perspective of investors? Could the layout be improved to enhance investor participation? Do the formats of proxy cards and VIFs appropriately set out the consequences of not voting or giving voting instructions on one or more specific matters?
- To what extent has the loss of broker discretionary votes in uncontested elections of directors increased the likelihood that issuers will not meet quorum requirements? Would the availability of less-costly means of communication with shareholders improve issuers' ability to meet quorum requirements?
- Do investors have legitimate privacy interests with respect to the disclosure of their share ownership? In what ways would an investor be harmed if his or her identity and the size of his or her holdings are disclosed to issuers? Should an investor be able to indicate that he or she does not wish to be contacted by an issuer? Do broker-dealers or banks have legitimate commercial interests in keeping the identities of their customers confidential? How should these interests be balanced against an issuer's interest in identifying and communicating with its investors? Is this balance different for individual and institutional investors, and if so, would different treatment in regard to OBO status be appropriate? Are there technological solutions that would facilitate communication while protecting the identities of shareholders?
- Issuers have expressed interest in not only communicating with shareholders, but also in identifying them. While these interests can be complementary, is one more important than the other? Should any regulatory changes that may be considered by the Commission emphasize one over the other?
- Are there merits to, or concerns about, establishing a central beneficial owner data aggregator for use by issuers, as suggested by the Shareholder Communications Coalition and as described above?
- Is competition in the proxy distribution service market needed, and if so, what changes to facilitate issuers' communications with investors would also encourage competition in the proxy distribution service market?
- Should we consider rules that would shift the cost of distributing proxy materials to broker-dealers for customers who choose to be objecting beneficial owners?

[164] *See, e.g.,* CII OBO/NOBO Report, note 141, above.

[165] *See* Exchange Act Rule 14b–1(b)(3)(i) [17 CFR 240.14b–1(b)(3)(i)] (requiring broker-dealers to provide names, addresses, and securities positions of customers who have not objected to disclosure of such information); Exchange Act Rule 14b–2(b)(4) [17 CFR 240.14b–1(b)(3)(i)] (requiring banks to provide names, addresses, and securities positions of customers that have not objected to disclosure of such information for customer accounts established after December 28, 1986, but requiring affirmative consent to disclosure of such information for customer accounts opened before that date).

[166] *See* SIFMA Report, note 134, above, at 10, 12, 20–22.

[167] Investor Attitudes Study Conducted for NYSE Group—April 7, 2006, *available at http://www.nyse.com/pdfs/Final_ORC_Survey.pdf.* In that study, 71% of respondents indicated that they would provide contact information to the issuers in which they invest if asked. In addition, the study notes that investor preference for NOBO status increases if fees are imposed on continuing to maintain OBO status: with the imposition of a $50 annual fee, preference for OBO status declines from 36% to 5%. *Id.* at 3.

• Do our rules adequately address how beneficial owners elect objecting or non-objecting beneficial owner status when they open their accounts? Should there be a requirement that beneficial owners' account agreements adopt any specific election as the default choice? If so, would it matter whether the Commission, FINRA, or the stock exchanges imposed that requirement? Should the required default choice be for objecting or non-objecting beneficial owner status? Are there other ways in which default positions can be established for customers of securities intermediaries? Should there be a standardized form for customers to elect either NOBO or OBO status?

• Should we or SROs instead, or in addition, consider requiring securities intermediaries to provide informational materials to their customers prior to allowing the customer to elect OBO or NOBO status? What should be included in such informational materials, and how frequently should investors be provided with such materials? Should we consider requiring securities intermediaries to inform customers of the reasons for and against choosing to disclose or shield their identities?

• Should a broker-dealer periodically request that customers reaffirm their OBO/NOBO status selection? If so, how should the cost of this periodic evaluation be allocated?

• Should we consider revising our rules to require that securities intermediaries provide an omnibus proxy to their underlying beneficial owners and identify them to the issuer? If we were to propose such a rule, should we limit it to granting proxies to NOBOs since their identities are already available to issuers? How would such a system address the way securities transactions are cleared and settled?

• What are the costs and benefits of the annual NOBO system suggested by commentators? Would disclosure of all beneficial owners, limited to information as of the record date of a shareholder meeting, harm those investors (for example, would it reveal trading strategies of those investors)? Would implementing the annual NOBO system adversely affect any privacy interests of OBOs? As a practical matter, would issuers be able to contact OBOs using this information for subsequent shareholder meetings?

• What problems might arise if issuers or their transfer agents have greater access to or control of shareholder lists? How could we provide for fair and efficient access to those lists by other soliciting parties?

B. Means To Facilitate Retail Investor Participation

1. Background

As we seek to promote and facilitate shareholder voting in general, we understand that the level of voting by retail investors is a particular area of concern. Retail investor participation rates in the proxy voting process historically have been low.[168] Given the importance of proxy voting, we view significant lack of participation by retail investors in proxy voting as a source of concern, even in companies in which retail share ownership represents a relatively small portion of total voting power. We understand that this situation is not limited to the U.S., as the level of voting by shareholders in other jurisdictions has also caused concern.[169]

2. Potential Regulatory Responses

a. Investor Education

Commentators have indicated that there is confusion among investors regarding the proxy voting process and the importance of voting.[170] Investors accustomed to brokers voting their shares on their behalf may be unaware that, as a result of the recent revisions to NYSE Rule 452, brokers can no longer vote investors' shares in uncontested elections of corporate directors without instructions from the investors. In addition, many investors may be confused by the distinction between record and beneficial ownership and how that may affect their voting rights. These commentators have recommended the development of a significant investor education campaign to inform investors about the proxy voting process and the importance of voting as one way in which communication and proxy voting could be improved.

We believe that improved investor education may help dispel some of these potential misunderstandings and create interest in the voting process. There are several ways in which we can enhance the educational opportunities for investors. We recently created a new section on our investor site, *http://www.investor.gov*, to provide educational materials about proxy mechanics generally and the notice and access model for the delivery of proxy materials. The new proxy matters section can be found at *http://www.investor.gov/proxy-matters*.[171] We understand that a number of issuers and shareholder organizations have provided links from their Web sites to these educational materials. In addition, NYSE recently revised examples of letters containing the information and instructions required to be given by NYSE members to beneficial owners to inform beneficial owners that brokers are no longer allowed to vote shares held by beneficial owners on uncontested elections of directors, unless the beneficial owner has provided voting instructions.[172]

Another possible venue for investor education is issuers' Web sites and brokers' Web sites. Many investors go to issuer Web sites to obtain information about the issuers in which they invest, and an increasing number of investors review their holdings and effect securities transactions through their brokers' Web sites. More proxy-related educational materials located on an issuer's or broker's Web site may be helpful to investors. In addition, although some explanation of how the proxy process works is often included on the back of the proxy card (or on the VIF), that information can be difficult to read and is often presented in small print. We are interested in whether improving the presentation of information on the proxy card or VIF would have an effect on voting participation.

Finally, we are interested in whether we should also consider the scope, format, and content of the communications between brokers and their customers that occur in connection with opening customers' accounts. The account-opening process may be a good

[168] *See* Roundtable Briefing Paper, note 79, above.

[169] *See, e.g.,* Myners Report, note 15, above.

[170] *See* Proxy Working Group Report, note 107, above, at 15.

[171] The staff of the Commission initiated an educational program on proxy voting matters for retail investors with the goal of increasing investor awareness about the importance of participating in director elections and other issues brought before shareholders at annual and special meetings. A plain-language "Spotlight on Proxy Matters page" in question and answer format was developed on the SEC Web site to explain proxy voting procedures. In addition, the staff of our Office of Investor Education and Advocacy has spoken before investor and issuer organizations to promote the Web site material and to urge their involvement in proxy voting educational programming. To date, this ongoing effort has yielded more than 25,000 unique visits to the Proxy Matters Web site and 1,430 references on Google. The staff plans to continue and expand the education and outreach to retail investors in preparation for the 2011 proxy season. As part of this outreach program, we are exploring potential opportunities to link proxy educational materials directly to online brokerage accounts and other locations that may be visited frequently by retail shareholders.

[172] *See* Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify the Sample Broker Letters Set Forth In Rule 451, Release No. 34–61046 (Nov. 20, 2009) [74 FR 62849].

opportunity to communicate important information about the shareholder voting process.

b. Enhanced Brokers' Internet Platforms

As noted above, many investors use their brokers' Web sites as "one-stop shopping" for their investment needs. It is our understanding, however, that many of these Web sites do not provide information about upcoming corporate actions or enable retail investors to use the same platform for proxy voting. Rather, many brokers hire a third-party proxy service provider to handle the collection of voting instructions. Therefore, those investors must go to a different Web site, not run by the broker, in order to submit voting instructions to their broker. We are interested in receiving views on whether receiving notices of upcoming corporate votes and having the ability to access proxy materials and a VIF through the investor's account page on the broker's Web site would be helpful to investors. We also wish to explore whether other communications from broker to customer could encourage more active and better informed participation in the proxy voting process.

c. Advance Voting Instructions

Some commentators have recommended that we adopt rules to facilitate what has been called "client-directed voting" as a means to increase investor participation in the voting process.[173] In general, this concept contemplates that brokers or other parties [174] would solicit voting instructions from retail investors on particular topics (*e.g.,* election of directors, ratification of auditors, approval of equity compensation plans, action on shareholder proposals) in advance of their receiving the proxy materials from companies.[175] The advance voting instructions would then be applied to proxy cards or VIFs related to the investors' securities holdings, unless the investors changed those instructions. Investors would be able (but not required) to instruct their securities intermediaries or other parties to vote their shares in any number of ways, including the following:

- Vote shares in accordance with the board of directors' recommendations;
- Vote shares against the board of directors' recommendations;
- Vote shares related to particular types of proposals (for example, shareholder proposals related to environmental or social issues) consistent with recommendations issued by specified interest groups, proxy advisory firms, investors, or voting policies;
- Abstain from voting shares; or
- Vote shares proportionally with the brokerage firm's customers' instructed votes, or the instructed votes of its institutional or retail customers only.[176]

The advance voting instructions would generally be given by the investors at the time they sign their brokerage agreements or sign up for the proxy voting service, or periodically thereafter, and would always be revocable. Investors would also be able to change the advance voting instructions at any time.

In connection with each proxy solicitation, investors who had given advance voting instructions would receive a proxy card or VIF pre-marked in accordance with those voting instructions, along with the proxy materials required by the federal securities laws. Investors could override any of the advanced voting instructions applicable to that proxy solicitation by checking or clicking on an appropriate election box before the vote is submitted. Absent instructions to the contrary, the securities intermediary or other party would vote the investor's shares in accordance with the advance voting instructions as pre-marked on the proxy card or VIF.

In connection with the proposal to amend NYSE Rule 452,[177] we received several comment letters that discussed advance voting instructions as an alternative to the NYSE Rule 452 amendment [178] or advocated that such voting instructions should be considered in conjunction with the NYSE Rule 452 amendment.[179] In the order approving the NYSE Rule 452 amendment, we noted that advance voting instructions raise a variety of questions and concerns, such as requiring investors to make a voting decision in advance of receiving a proxy statement containing the disclosures mandated under the federal securities laws and possibly without consideration of the specific issues to be voted upon.[180] The Proxy Working Group also expressed concern that advance voting instructions could act as a disincentive for retail investors to vote after reviewing proxy materials if they had already given such instructions.[181] On the other hand, supporters of advance voting instructions stated that the implementation of voting based on such instructions could help issuers solve quorum problems, encourage greater retail shareholder participation in the voting process by making it easier for investors to vote, better permit shareholders to exercise their franchise, and result in more discussion and involvement between investors and their brokers on proxy issues.[182]

While we will continue to consider the advisability of allowing third parties, such as broker-dealers, to solicit instructions regarding the voting of shares by retail investors without the benefit of information that is contained in disclosures that our rules require in connection with shareholder votes, we recognize that facilitating the use of advance voting instructions can be

[173] *See* Proxy Working Group Addendum, note 127, above. We use the term "advance voting instructions" rather than "client-directed voting" because we believe it more precisely identifies the salient feature of this approach to shareholder voting.

[174] Such parties could include proxy advisory firms or other third parties offering voting platforms to facilitate voting by retail investors.

[175] As noted above, proxy advisory services sometimes submit votes on behalf of their institutional investor clients pursuant to the clients' proxy voting policies.

[176] *See* Proxy Working Group Addendum, note 127, above; *see also* John Wilcox, Fixing the Problems with Client-Directed Voting, March 5, 2010, *available at http://blogs.law.harvard.edu/corpgov/2010/03/05/fixing-the-problems-with-client-directed-voting/.*

[177] On July 1, 2009, the Commission approved an amendment to NYSE Rule 452 and Section 402.08 of the NYSE Listed Issuer Manual that eliminated discretionary voting by brokers in uncontested director elections. *See* Release No. 34–60215, note 11, above.

[178] *See* comment letters from American Bar Association ("ABA Letter"); American Business Conference; Agilent Technologies, Inc.; Business Roundtable; United States Chamber of Commerce; Connecticut Water; DTE Energy; First Financial Holdings, Inc.; Furniture Brands International; General Electric; Intel Corporation; Jacksonville Bancorp Inc.; McKesson Corporation; Monster Worldwide, Inc.; Nucor Corporation; Provident Bank; Provident Financial Services, Inc.; Quest Diagnostics Inc.; Synalloy Corporation; and Veeco Instruments Inc to Notice of Filing of Proposed Rule Change, as modified by Amendment No. 4, to Amend NYSE Rule 452 and Listed Company Manual Section 402.08 to Eliminate Broker Discretionary Voting for the Election of Directors and Codify Two Previously Published Interpretations That Do Not Permit Broker Discretionary Votes for Material Amendments to Investment Advisory Contracts, Release No. 34–59464 (Feb. 26, 2009), *available at http://www.sec.gov/comments/sr-nyse-2006–92/nyse200692.shtml.*

[179] *See* comment letters from American Express; Society of Corporate Secretaries and Governance Professionals ("Governance Professionals Letter"); Honeywell; JPMorgan Chase & Co.; and Shareholder Communications Coalition to Release No. 34–59464, note 178, above, *available at http://www.sec.gov/comments/sr-nyse-2006–92/nyse200692.shtml.*

[180] *See* Release No. 34–60215, note 11, above, at 34.

[181] *See* Proxy Working Group Addendum, note 127, above, at 5.

[182] *Id.* at 5–6. *See also* Governance Professionals Letter, note 179, above; ABA Letter, note 177, above; and Frank G. Zarb, Jr. and John Endean, "The Case for 'Client Directed Voting,'" Law 360 (Jan. 4, 2010).

viewed as providing retail investors with a component of the services now made available to institutional investors by proxy advisory firms. However, retail investors are not necessarily in the same position as institutional investors. Some institutional investors rely upon pre-developed voting policies and procedures to ensure consistency across portfolios, to aid in post-vote monitoring and reporting, and otherwise to comply with applicable fiduciary duties. Some retail shareholders may not be as likely to monitor, or hire others to monitor, the application of their advance voting instructions.

There is currently no applicable exemption for securities intermediaries to solicit advance voting instructions from their customers. Exchange Act Rule 14a–2(a)(1) provides an exemption from the proxy solicitation rules to securities intermediaries when they forward proxy materials on behalf of issuers and request voting instructions.[183] This exemption, however, requires securities intermediaries to "promptly furnish" proxy materials to the person solicited. By definition, brokers seeking to obtain advance voting instructions from customers would not be able to satisfy this requirement. In the absence of an applicable exemption for the solicitation of advance voting instructions, Rule 14a–4(d) states that no proxy shall confer authority to vote at any annual meeting other than the next annual meeting after the date on which the form of proxy is first sent.[184] In addition, that rule prohibits a proxy from granting authority to vote with respect to more than one meeting.[185]

To pursue this alternative further, there are a number of issues that would need to be considered. Advance voting instructions could be solicited to varying levels of detail. For instance, such an instruction could be very broad, such as "vote consistent with management's recommendations" or "vote consistent with the recommendations of XYZ Environmental Group." The grant of such broad authority could raise concerns about the extent to which the investor's vote is an informed one. Greater specificity in a request for instructions, however, could provide an investor with greater certainty regarding what his or her instruction relates to. For example, an instruction to "vote consistent with [management's or other party's] recommendations regarding corporate governance issues" would provide more certainty.

In addition, if we were to permit advance voting instructions, we would need to address other issues including whether such instructions should be re-affirmed on a periodic basis; whether they should apply to the voting of shares of issuers that the investor did not own when the original instructions were submitted; whether they should be re-affirmed each time an investor purchases additional shares of an issuer's stock for which that investor has already submitted voting instructions; and whether brokers can seek from investors advance voting instructions that vary by company.

We are interested in receiving views on whether permitting advance voting instructions would increase retail investor participation in the voting process, and on whether such instructions would be appropriate as a general matter. If such instructions would increase retail investor participation and would be appropriate, we are interested in receiving views on any conditions or requirements that we should consider applying to the solicitation of such instructions.

d. Investor-to-Investor Communications

We are interested in receiving views on whether investor interest in matters presented to shareholders is affected by the extent to which investors are able to communicate with other investors about their opinions regarding matters up for a vote. It is our understanding that there tends to be higher voting participation in situations that involve increased communications and high investor interest, such as well-publicized proxy contests. We have, in the past, adopted several provisions designed to enhance shareholder communications between investors and the issuer, as well as among investors, including:

- Exempting communications with investors from the proxy statement delivery and disclosure requirements where the soliciting person is not seeking proxy authority and does not have, among other things, a substantial interest in the matter (other than as an investor in the issuer);[186]
- Permitting an investor to publicly announce how it intends to vote and provide the reasons for that decision without having to comply with the proxy rules;[187] and
- Broadening the types of communications that are permissible prior to the distribution of a definitive proxy statement.[188]

In addition, in 2007, we adopted rules promoting the use of electronic shareholder forums on the Internet for investor communications.[189] It is our understanding that such forums have not been used extensively. We are interested in receiving views on whether, if further steps are taken to facilitate informed discussion among investors, the level of investor voting participation and informed proxy voting would be likely to increase. In addition, we are interested in receiving views on whether any additional forums for shareholder-to-shareholder communications would be helpful.

e. Improving the Use of the Internet for Distribution of Proxy Materials

In 2007, we amended the proxy rules to adopt a "notice and access model."[190] This model provides issuers with two options for making their proxy materials available: the "notice-only option"[191] and the "full set delivery option." Under the notice-only option, the issuer must post its proxy materials on a publicly-accessible Web site and send a notice to shareholders at least 40 days before the shareholder meeting date to inform them of the electronic availability of the proxy materials, and explain how to access those materials.[192] Under this option, an issuer must also provide paper or e-mail copies of proxy materials at no charge to shareholders who request such copies.[193]

Issuers may also select the "full set delivery" option, where the issuer

[183] 17 CFR 240.14a–2(a)(1).

[184] 17 CFR 240.14a–4(d)(2).

[185] 17 CFR 240.14a–4(d)(3).

[186] 17 CFR 240.14a–2(b)(1). The rule specifies certain individuals and entities, such as affiliates of the registrant, that are not entitled to rely on the exemption. Also, if the shareholder owns more than $5 million of the registrant's securities, it must furnish a Notice of Exempt Solicitation to the Commission. 17 CFR 240.14a–6(g).

[187] 17 CFR 240.14a–1(*l*)(2)(iv).

[188] 17 CFR 240.14a–12; Regulation of Takeovers and Security Holder Communications, Release No. 33–7760 (Oct. 22, 1999) [64 FR 61408].

[189] *See* Release No. 34–57172, note 3, above.

[190] *See* Notice and Access Release, note 2, above.

[191] The notice and access model is a concept separate from, but complementary to, electronic delivery. The notice and access model permits an issuer (or a securities intermediary at the direction of the issuer) to deliver a notice (typically in paper) informing shareholders that proxy materials are available on the Internet in lieu of sending a full paper set of proxy materials. Electronic delivery, on the other hand, arises from our guidance in Release No. 33–7233, note 32, above. In that release, we explained that delivery of materials (including proxy materials) may be made electronically under certain circumstances, including if a shareholder has provided affirmative consent to electronic delivery. An issuer or securities intermediary may send this notice electronically to a shareholder if that shareholder has affirmatively consented to electronic delivery.

[192] *See* 17 CFR 240.14a–16; Notice and Access Release, note 2, above.

[193] 17 CFR 240.14a–16.

delivers a full set of proxy materials to shareholders, along with the Notice of Internet Availability of Proxy Materials on a Web site, and posts the proxy materials to a publicly-accessible Web site.[194] An issuer may use the notice-only option to provide proxy materials to some shareholders, and the full set delivery option to provide proxy materials to other shareholders.[195]

It has been suggested that our adoption of rules permitting the dissemination of proxy materials through a "notice and access" model has contributed to a decline in retail investor participation in voting. We believe that it is difficult to conclude, based on existing data, that notice and access has caused changes in voter participation. To be sure, the number of retail accounts submitting voting instructions when issuers use the notice-only option is lower than the number of retail accounts submitting voting instructions when issuers use the full-set delivery option. The number of retail shares being voted, however, does not appear to differ substantially.[196] More importantly, because issuers can elect whether to use the notice-only model, it is difficult to discern whether patterns in voting behavior are due to notice and access or to other factors. Issuers who choose the notice-only model may differ from other issuers in ways that may also correlate with voter participation, such as size or other characteristics. Some issuers have chosen a hybrid model, continuing to distribute full packages of proxy solicitation materials to selected shareholders based on the size of their holdings or their voting histories,[197] suggesting that these issuers may believe that full-set delivery affects voter participation in some cases.

Another possible option to encourage shareholder participation, while still allowing issuers to use the notice-only option, would be to permit the inclusion of a proxy card or VIF with the Notice of Internet Availability of Proxy Materials when an issuer or other soliciting shareholder elects to use the notice-only option under the notice and access model for the delivery of proxy materials. Currently, Exchange Act Rule 14a–16 explicitly prohibits the soliciting party from including a proxy card or VIF with the Notice in the same mailing.[198] Although we initially proposed a model that would have allowed soliciting parties to include a proxy card or VIF with the Notice, we ultimately adopted a rule that prohibited the inclusion of the proxy card or VIF and noted commentators' concerns that "physically separating the card from the proxy statement, as originally proposed, may lead to the type of uninformed voting that the proxy rules are intended to prevent."[199]

3. Request for Comment

With respect to investor education, we ask the following questions:

- To what extent should we take additional steps to encourage retail investor participation in the proxy process?
- To what extent would greater use of plain English, some form of summary of proxy materials, or layered formats in Web-based disclosure make proxy materials more accessible to retail investors?
- To what extent are retail voter participation levels affected by process-related impediments to participation? If affected by impediments, what are they and should we seek to remove them? What costs and benefits are associated with efforts to increase participation?
- Would additional investor education improve retail investor participation in the proxy process? How could such a program best reach both registered owners and beneficial owners? What would be the benefits and costs of such a program? What should be in the educational materials and who should decide what goes in them?
- Should brokers more clearly highlight and disclose key policies, including a shareholder's voting rights and default positions, such as OBO/NOBO, when a customer enters into a brokerage agreement? Should brokers provide counseling to potential customers to enhance understanding of such provisions in the brokerage agreement? When a customer enters into a brokerage agreement, should brokers be required to obtain the preferences of the client regarding whether to receive proxy materials electronically, and inform issuers of that election automatically when securities of that issuer are purchased?
- What role should the Commission play in promoting or developing the education campaign? How can the SEC's investor education Web sites be made more useful? For example, should the Web site provide interactive instruction?

With respect to enhanced issuers' and brokers' Internet platforms, we ask the following questions:

- Would an issuer's Web site or a broker's Web site be a useful location for investor educational information? Are there other methods to effectively educate investors? What would be the costs and benefits of requiring issuers or securities intermediaries to include such information on their Web sites?
- Should issuers or brokers enhance their Web sites, if they have one, to provide the issuers' shareholders or the brokers' customers, respectively, with the ability to receive notices of upcoming corporate votes, to access proxy materials and to vote shares through their personal account pages? What would be the costs of such a system? Would adding this service for investors make them more likely to vote? To what extent do issuers and brokers currently provide such functionality on their Web sites?
- Should we encourage the creation of inexpensive or free proxy voting platforms that would provide retail investors with access to proxy research, vote recommendations, and vote execution? If so, how?

With respect to advance voting instructions, we ask the following questions:

- Should we consider allowing securities intermediaries to solicit voting instructions in advance of distribution of proxy materials pursuant to an exemption from the proxy solicitation rules? Should there be any conditions on any such exemption, and if so, what should they be?
- To what extent would voting instructions made without the benefit of proxy materials result in less informed voting decisions? Are there countervailing benefits to permitting the solicitation of such instructions? To what extent does the revocability of advance voting instructions mitigate concerns over less informed voting decisions?
- With regard to the use of advance voting instructions, are retail investors at a disadvantage as compared to institutional investors that use the

[194] *Id.* The issuer may elect to include all of the information required to appear in the Notice in the proxy statement and proxy card. *Id.*

[195] *Id.*

[196] *See* Broadridge, Notice and Access: 2010 Statistical Overview of Use with Beneficial Shareholders, *available at http://www.broadridge.com/notice-and-access/FY10_full_year.pdf* ("2010 Broadridge Statistical Overview"). This report indicates that, during the 2009 and 2010 proxy seasons, 31.95% and 27.29%, respectively, of retail shares were voted at issuers not using notice and access, while 28.70% and 31.01%, respectively of retail shares were voted at issuers using notice and access. On the other hand, 19.39% and 19.21%, respectively, of retail accounts were voted at issuers not using notice and access, while 12.72% and 13.85%, respectively, of retail accounts were voted at issuers using notice and access.

[197] *Id.*

[198] 17 CFR 240.14a–16(e). A proxy card or VIF may be included with a Notice if at least 10 days have passed since the date a Notice was first sent to shareholders. 17 CFR 240.14a–16(h)(1).

[199] Internet Availability of Proxy Materials, Release No. 34–55146 (Jan. 22, 2007) [72 FR 4148] at 4153.

services of a proxy advisory firm? If so, how? Are there aspects of the services and relationship between proxy advisory firms and their clients that would not exist between securities intermediaries soliciting advance voting instructions and their customers? If so, how should these differences be addressed, if at all?

• If such solicitation of advance voting instructions were permitted, what level of specificity should the solicitation of advanced voting instructions be required (or permitted) to have? Is it appropriate to permit the solicitation of a broad scope of voting authority?

• Should we allow the solicitation by securities intermediaries of advance voting instructions for all types of proxy proposals, or should it be limited to certain types of proposals? For example, should we permit solicitation of advance voting instructions with respect to shareholder proposals, proxy contests, or proposals subject to "vote no" campaigns?

• If solicitation of advance voting instructions were permitted, should the investor be permitted to instruct the securities intermediary to vote in accordance with the recommendations of management, a proxy advisory firm, or other specified persons? How neutral or balanced should the solicitation of advance voting instructions be?

• If we were to allow the solicitation of advance voting instructions, should we require an investor to reaffirm its voting instructions periodically? If so, how often? Should we require an investor to reaffirm its voting instructions every time it purchases additional shares of a stock for which that investor has already submitted a voting instruction, or when it purchases shares of a new issuer?

• If we were to allow advance voting instructions, what would be an appropriate range of options available to an investor? Should advance voting instructions only be permitted when the investor has meaningful options from which to choose?

• How difficult would it be to obtain advance voting instructions from existing brokerage customers? What would be the costs of obtaining advance voting instructions for existing accounts? Who should bear the costs of soliciting such instructions?

• If we were to allow the solicitation of advance voting instructions, would it undermine or promote the purpose of the recent amendment to NYSE Rule 452 to prohibit brokers from voting uninstructed shares in uncontested elections of directors?

With respect to investor-to-investor communications, we ask the following questions:

• To what extent are investor interest in matters presented to shareholders and investor voting participation affected by the lack of investor-to-investor communications regarding those matters?

• Have electronic shareholder forums been used extensively? Are there any revisions to Rule 14a–2(b)(6), which currently provides an exemption for electronic shareholder forums, that would make it easier to establish such forums? For example, is there a way for an entity establishing an electronic shareholder forum to confirm the shareholder status of participants on the forum? If a securities intermediary provides information, such as a control number, to enable such confirmation, should precautions be taken to ensure that personal information about those investors is not disclosed?

• Should we consider revising the electronic shareholder forum rules to shorten the 60-day period to promote more shareholder-to-shareholder communication closer to the meeting date? If so, what would be an appropriate time period?

• Are there any other new rules or revisions to existing rules that would facilitate communications among investors? If so, what would those revisions be?

• Would any additional guidance regarding the scope of our rules and definitions, such as the definition of the term "solicitation," improve the extent and quality of investor participation in the proxy voting process?

With respect to possible revisions to the notice and access model, we ask the following questions:

• Should we consider requiring that companies using a "notice and access" model for distributing proxy materials use that model on a stratified basis to encourage retail voting participation? For example, should we require that issuers send full sets of proxy materials to shareholders who have voted on paper in the past two years?

• Should we consider amending our rules to permit inclusion of a proxy card or VIF with a Notice of Internet Availability of Proxy Materials?

• Are there other changes that we can make to the notice and access model to improve voting participation? For example, should we require affirmative consent from a shareholder before an issuer is allowed to send that customer only a Notice of Internet Availability of Proxy Materials? Should we eliminate the notice and access model altogether?

C. Data-Tagging Proxy-Related Materials

1. Background

Issuers soliciting proxies are required to distribute a proxy statement [200] and to disclose the results of shareholder votes within four business days after the end of the meeting at which the vote was held.[201] Funds are generally required to disclose annually on Form N–PX [202] how they vote proxies relating to portfolio securities.[203] In the discussion below, we address whether this information could be organized and made available to investors in ways that might enhance the level and quality of shareholder participation in the proxy voting process.

In 2004, as part of our longstanding efforts to increase transparency in general and the usefulness of information in particular, we began an initiative to assess the benefits of interactive data [204] and its potential for improving the timeliness, accuracy, and analysis of financial and other filed information.[205] Data becomes interactive when it is labeled, or "tagged," using a computer markup language that can be processed by software for analysis. Such computer markup languages use standard sets of definitions, or "taxonomies," that translate text-based information in Commission filings into interactive data that can be retrieved, searched, and analyzed through automated means.

Our efforts regarding interactive data thus far have resulted in our adoption of rules that, in general, currently or ultimately will require:

• Public issuers, including foreign private issuers, to provide their financial statements to the Commission and on their corporate Web sites, if any,

[200] The proxy statement must include the information required by Schedule 14A of the Exchange Act. [17 CFR 240.14a–101] The Commission's rules also generally require issuers not soliciting proxies from shareholders entitled to vote on a matter to distribute an information statement that must include the similar information required by Schedule 14C of the Exchange Act [17 CFR 240.14c–101]. Accordingly, the data-tagging discussion in this Section IV.C relates to the information required by Schedule 14C in the same manner it relates to corresponding information required by Schedule 14A.

[201] Item 5.07 of Form 8–K [referenced in 17 CFR 249.308].

[202] 17 CFR 274.129. See Section III.C, above, for a further discussion of Form N–PX.

[203] In this Section IV.C, we use the term "proxy statement and voting information" to refer collectively to the information required by Schedule 14A, Schedule 14C, Item 5.07 of Form 8–K and Form N–PX.

[204] In this Section IV.C, we generally refer to "tagged data" as "interactive data" because users are able to interact with the data by processing it.

[205] *See* Press Release No. 2004–97 (July 22, 2004), *available at http://www.sec.gov/news/press/2004–97.htm.*

in interactive data format using eXtensible Business Reporting Language ("XBRL");[206]

- Mutual funds[207] to provide the risk/return summary section of their prospectuses to the Commission and on their Web sites, if any, in XBRL format;[208]
- Rating agencies to provide certain ratings information on their Web sites in XBRL format;[209]
- Money market funds to provide portfolio holdings information to the Commission in interactive data format using eXtensible Markup Language ("XML");[210]
- Transfer agents to provide registration, activity and withdrawal information to the Commission in XML format;[211]
- Issuers to provide notice of Regulation D[212] exempt offering information to the Commission in XML format[213] or through the Commission's online forms Web site that tags the information in XML;[214] and
- Officers, directors, and principal owners to provide beneficial ownership information under Section 16(a) of the Exchange Act[215] to the Commission in XML format[216] or through the Commission's online forms Web site that tags the information in XML.[217]

Currently, proxy statement and voting information is neither required nor permitted to be provided to the Commission in interactive data format. As a result, shareholders cannot retrieve, search, and use this information through automated means in the form in which it is provided to the Commission.

2. Potential Regulatory Responses

We are interested in receiving views on whether it would be beneficial to investors to permit or require issuers, including funds, to provide proxy statement and voting information in interactive data format in addition to the traditional format. We are also interested in understanding the costs of providing additional tagged information. A significant amount of the textual data in the proxy statement is well-structured and may be suitable for data tagging. If issuers provided reportable items in interactive data format, shareholders may be able to more easily obtain specific information about issuers, compare information across different issuers, and observe how issuer-specific information changes over time as the same issuer continues to file in an interactive data format. This could both facilitate more informed voting and investment decisions and assist in automating regulatory filings and business information processing.[218]

Under our current rules, issuers are permitted or required to provide specified information in interactive data format only as described above. We have, however, previously considered, and sought comment on, permitting or requiring interactive data for other types of information in XBRL or another format.[219] Most recently, in the 2008 release proposing the required filing of financial statements in XBRL format,[220] we expanded upon our 2006 request for comment on making executive compensation information available in interactive data format.[221] In the 2008 release, we did not propose permitting or requiring interactive data for executive compensation, but asked a series of questions related to whether we should. As noted in the 2009 release adopting the financial statement XBRL requirements, some commentators supported the idea of eventually tagging non-financial statement information such as executive compensation because of its usefulness to investors,[222] while others expressed concern that variations among issuers in executive compensation practices may not lend themselves to the development of standard tags and suggested that any tagging be voluntary rather than required.[223]

In connection with our efforts to improve communication in the proxy context, we are interested in receiving views on whether we should reconsider whether to permit or require proxy statement and voting information to be provided in interactive data format.[224]

[206] Interactive Data to Improve Financial Reporting, Release No. 33–9002 (Jan. 30, 2009) [74 FR 6776] as corrected by Interactive Data to Improve Financial Reporting, Release No. 33–9002A (Apr. 1, 2009) [74 FR 15666]. Issuers that are or will be required to provide their financial statements in interactive data format using XBRL are permitted to provide such interactive data before they are required to do so. Funds are permitted to provide financial information in interactive data format using XBRL as an exhibit to certain filings in our electronic filing system under a voluntary filer program that initially was implemented in 2005.

[207] In this Section IV.C, we use the term "mutual fund" to mean an open-end management investment company. An open-end management investment company is an investment company, other than a unit investment trust or face-amount certificate company, which offers for sale or has outstanding any redeemable security of which it is the issuer. *See* Sections 4 and 5(a)(1) of the Investment Company Act [15 U.S.C. 80a–4 and 80a–5(a)(1)].

[208] Interactive Data for Mutual Fund Risk/Return Summary, Release No. 33–9006 (Feb. 11, 2009) [74 FR 7748] as corrected by Interactive Data for Mutual Fund Risk/Return Summary; Correction, Release No. 33–9006A (May 1, 2009) [74 FR 21255]. Mutual funds are permitted to provide their risk/return summary information in interactive data format (using XBRL) before they are required to do so. The public companies, foreign private issuers and mutual funds permitted or required to provide financial statement or risk/return summary information in interactive data format are required to continue to provide the information in traditional format as well.

[209] Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34–61050 (Nov. 23, 2009) [74 FR 63832] and Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Release No. 34–59342 (Feb. 2, 2009) [74 FR 6456].

[210] Money Market Fund Reform, Release No. IC–29132 (Feb. 23, 2010) [75 FR 10060]. The XBRL format is compatible with and derives from the XML format.

[211] Electronic Filing of Transfer Agent Forms, Release No. 34–54864 (Dec. 4, 2006) [71 FR 74698].

[212] 17 CFR 230.501–508.

[213] *See* EDGAR Form D XML Technical Specification (Version 7.4.0), *available at http://www.sec.gov/info/edgar/formdxmltechspec.htm.*

[214] Electronic Filing and Revision of Form D, Release No. 33–8891 (Feb. 6, 2008) [73 FR 10592].

[215] 15 U.S.C. 78p(a).

[216] *See* EDGAR Ownership XML Technical Specification (Version 3), *available at http://www.sec.gov/info/edgar/ownershipxmltechspec.htm.*

[217] Mandated Electronic Filing and Web Site Posting for Forms 3, 4 and 5, Release No. 33–8230 (May 7, 2003) [68 FR 25788].

[218] We anticipate that any interactive data format version of the information permitted or required would not replace the traditional format version, at least not initially. In general, interactive data currently is machine-readable only. Without the use of software, interactive data is illegible to the human eye. As a result, we expect that any interactive data would be provided in a separate schedule or exhibit. It is possible, however, that at some point in the future technology will evolve in a manner that would permit human-readable text and interactive data to appear in the same document.

[219] With regard to format, we solicited comment in our 2004 interactive data concept release regarding the ability of interactive data to add value to Commission filings, whether in XBRL or another interactive data format. Enhancing Commission Filings Through the Use of Tagged Data, Release No. 33–8497 (Sept. 27, 2004) [69 FR 59111].

[220] Interactive Data to Improve Financial Reporting, Release No. 33–8924 (May 30, 2008) [73 FR 32794].

[221] Executive Compensation and Related Party Disclosure, Release No. 33–8655 (Jan. 27, 2006) [71 FR 6542]. In 2007, as further discussed below, our staff used XBRL to tag Summary Compensation Table data provided by large filers and created rendering software that enabled investors to not only view compensation information but also manually calculate compensation and compare compensation across companies. The software was called the Executive Compensation Reader. We made these efforts to show how interactive data might provide investors with easier and faster analysis. SEC Press Release 2007–268 (Dec. 21, 2007).

[222] *See, e.g.,* comment letter to Release No. 33–9002, note 206, above, from California Public Employees' Retirement System.

[223] *See, e.g.,* comment letters to Release 33–9002, note 206, above, from American Bar Association, Johnson & Johnson, Pfizer, General Mills, and Society of Corporate Secretaries and Governance Professionals.

[224] Our solicitation of comment regarding providing proxy statement and voting information in interactive data format is consistent with the Resolution on Tag Data for Proxy and Vote Filings adopted by the Securities and Exchange Commission Investor Advisory Committee. *See*

Continued

3. Request for Comment

• Should we permit issuers, including funds, to provide proxy statement and voting information to the Commission and on their corporate Web sites, if any, in an interactive data format? If so, are there benefits to one tagging language (*e.g.,* XBRL) over another? [225] Should we require issuers to provide such information to the Commission and on their corporate Web sites, if any, in an interactive data format? Should we also permit or require the tagging of executive compensation information even if it is not in the proxy statement, but rather, in the annual report on Form 10–K? [226]

• Are there any other types of information for which we should permit or require tagging in order to improve the efficiency and quality of proxy voting? For example, should we permit or require tagging of information contained in proxy statements filed by non-management parties?

• If we permit or require interactive data for the information contained in a proxy statement, should we permit or require it for only a subset of that information, such as executive compensation,[227] director experience [228] and other directorships,[229] transactions with related persons,[230] or corporate governance? [231] Should we permit or require it for only a subset of executive compensation information, such as the Summary Compensation Table,[232] Director Compensation Table,[233] Outstanding Equity Awards at Fiscal Year-End Table,[234] or Compensation Discussion and Analysis? [235]

• Would it be useful to investors for issuers to provide their proxy statement and voting information, or some subset of that information, in interactive data format? If so, would it be useful for issuers to provide the information both to the Commission and on their corporate Web sites, if any? Would data-tagging enable investors to access proxy information more easily or to compare information regarding different issuers and/or changes in information over time with respect to a specific issuer or a set of issuers? Would this ability result in better informed voting decisions? For insance, should officer and director identities be tagged and linked to their unique Commission Central Index Key (CIK) identifier, which would enable investors to more easily determine whether they have relationships with other Commission filers? Would investors benefit if governance attributes, such as board leadership structure [236] and director independence, were tagged? [237]

• Would requiring issuers to provide proxy statements and voting information in interactive data format assist issuers in automating their business information processing?

• Approximately how much would it cost issuers to provide each of the following in interactive data format:

• All information contained in a proxy statement;

• Executive compensation information only; and

• Voting information disclosed pursuant to Item 5.07 of Form 8–K or Form N–PX?

• With respect to cost, would it be preferable to defer any requirement to tag proxy-related materials until the issuer has been fully phased-in to the financial statement interactive data requirements, or would it be relatively easy to accomplish the tagging of proxy-related materials before, or at the same time as, becoming subject to the financial statement requirements?

• Is it feasible for funds to tag Form N–PX in a manner that provides for uniform identification of each matter voted (*e.g.,* for every fund to assign the same tag to the election of directors at XYZ Corporation) if issuers of portfolio securities do not themselves create these tags by tagging their proxy statements? What alternatives exist, other than having issuers of portfolio securities tag their proxy statements and assign tags to each matter on their proxy statements, that could result in uniform tags being assigned by all funds on Form N–PX to each corporate matter? What would be the costs associated with those alternatives?

• Whether or not we permit or require interactive data tagging, should Form N–PX require standardized reporting formats so that comparisons between funds are easier?

• Should persons other than the issuer be required to file proxy materials in interactive data format?

• How will retail investors have access to interactive data/XBRL software that will enable them to take advantage of interactive data formats?

V. Relationship Between Voting Power and Economic Interest

As discussed below, investor and issuer confidence in the legitimacy of shareholder voting may be based on the belief that, except as expressly agreed otherwise, shareholders entitled to vote in the election of directors and other matters have a residual economic (or equity) interest in the company that is commensurate with their voting rights. To the extent that votes are cast by persons lacking such an economic interest in the company, confidence in the proxy system could be undermined. This section examines the possibility of misalignment of voting power in general and three areas in which concerns have been expressed about whether our regulations play a role in the misalignment of voting power from economic interest: The increasingly important role of proxy advisory firms; the impediments in our rules to allowing issuers to set voting record dates that more closely match the date on which voting actually occurs; and hedging and other strategies that allow the voting rights of equity securities to be held or controlled by persons without an equivalent economic interest in the company.

http://www.sec.gov/spotlight/invadvcomm/iacproposedresproxyvotingtrans.pdf.

[225] Currently, there apparently is no standard set of XBRL definitions, or "taxonomy," available to enable an issuer to provide proxy statement and voting information or any subset of such information in XBRL format. XBRL US, however, is developing a taxonomy for at least some information a proxy statement requires. *See http://xbrl.us/Learn/Pages/Initiatives.aspx* ("Broadridge Financial Solutions contributed a proxy taxonomy to XBRL US in Q4 2008. XBRL US will incorporate the taxonomy into a master digital dictionary of terms.").

[226] 17 CFR 249.310.

[227] As we noted in Release No. 33–8924, note 220, above, there was substantial interest in financial Web pages that linked to the Executive Compensation Reader that temporarily was posted on our Web site beginning in late 2007. The Executive Compensation Reader displayed the Summary Compensation Table disclosure of 500 large companies that followed the executive compensation rules adopted in 2006 in reporting 2006 compensation information in their proxy statements filed with the Commission. By using the reader, an investor could view amounts included in the Summary Compensation Table Stock Awards and Option Awards columns based on either the full grant date fair value of the awards granted during the fiscal year, or the compensation cost of awards recognized for financial statement reporting purposes with respect to the fiscal year, and recalculate the Total Compensation column accordingly.

[228] Item 401(e)(1) of Regulation S–K [17 CFR 229.401(e)(1)].

[229] Item 401(e)(2) of Regulation S–K [17 CFR 229.401(e)(2)].

[230] Item 404(a) of Regulation S–K [17 CFR 229.404(a)].

[231] Item 407 of Regulation S–K [17 CFR 229.407].

[232] Items 402(c) and 402(n) of Regulation S–K [17 CFR 229.402(c) and 402(n)].

[233] Items 402(k) and 402(r) of Regulation S–K [17 CFR 229.402(k) and 402(r)].

[234] Items 402(f) and 402(p) of Regulation S–K [17 CFR 229.402(f) and 402(p)].

[235] Item 402(b) of Regulation S–K [17 CFR 229.402(b)].

[236] Item 407(h) of Regulation S–K [17 CFR 229.407(h)].

[237] Item 407(a) of Regulation S–K [17 CFR 229.407(a)].

A. Proxy Advisory Firms

1. The Role and Legal Status of Proxy Advisory Firms

Over the last twenty-five years, institutional investors, including investment advisers, pension plans, employee benefit plans, bank trust departments and funds, have substantially increased their use of proxy advisory firms, reflecting the tremendous growth in institutional investment as well as the fact that, in many cases, institutional investors have fiduciary obligations to vote the shares they hold on behalf of their beneficiaries.[238] Institutional investors typically own securities positions in a large number of issuers.

Every year, at shareholders' meetings, these investors face decisions on how to vote their shares on a significant number of matters, ranging from the election of directors and the approval of stock option plans to shareholder proposals submitted under Exchange Act Rule 14a–8,[239] which often raise significant policy questions and corporate governance issues. At special meetings of shareholders, investors also face voting decisions when a merger or acquisition or a sale of all or substantially all of the assets of the company is presented to them for approval.

In order to assist them in exercising their voting rights on matters presented to shareholders, institutional investors may retain proxy advisory firms to perform a variety of functions, including the following:

- Analyzing and making voting recommendations on the matters presented for shareholder vote and included in the issuers' proxy statements;
- Executing votes on the institutional investors' proxies or VIFs in accordance with the investors' instructions, which may include voting the shares in accordance with a customized proxy voting policy resulting from consultation between the institutional investor and the proxy advisory firm, the proxy advisory firm's proxy voting policies, or the institution's own voting policy;
- Assisting with the administrative tasks associated with voting and keeping track of the large number of voting decisions;
- Providing research and identifying potential risk factors related to corporate governance; and
- Helping mitigate conflict of interest concerns raised when the institutional investor is casting votes in a matter in which its interest may differ from the interest of its clients.[240]

Firms that are in the business of supplying these services to clients for compensation—in particular, analysis of and recommendations for voting on matters presented for a shareholder vote—are widely known as proxy advisory firms.[241] Institutional clients compensate proxy advisory firms on a fee basis for providing such services, and proxy advisory firms typically represent that their analysis and recommendations are prepared with a view toward maximizing long-term share value or the investment goals of the institutional client.

Issuers may also be consumers of the services provided by some proxy advisory firms. Some proxy advisory firms provide consulting services to issuers on corporate governance or executive compensation matters, such as assistance in developing proposals to be submitted for shareholder approval. Some proxy advisory firms also qualitatively rate or score issuers' corporate governance structures, policies, and practices,[242] and provide consulting services to corporate clients seeking to improve their corporate governance ratings. As a result, some proxy advisory firms provide vote recommendations to institutional investors on matters for which they also provided consulting services to the issuer. Some proxy advisory firms disclose these dual client relationships; others also have opted to attempt to address the conflict through the creation of "fire walls" between the investor and corporate lines of business.

Depending on their activities, proxy advisory firms may be subject to the federal securities laws in at least two notable respects. First, because of the breadth of the definition of "solicitation,"[243] proxy advisory firms may be subject to our proxy rules because they provide recommendations that are reasonably calculated to result in the procurement, withholding, or revocation of a proxy. As a general matter, the furnishing of proxy voting advice constitutes a "solicitation" subject to the information and filing requirements in the proxy rules.[244] In 1979, however, we adopted Exchange Act Rule 14a–2(b)(3)[245] to exempt the furnishing of proxy voting advice by any advisor to any other person with whom the advisor has a business relationship from the informational and filing requirements of the federal proxy rules, provided certain conditions are met.[246] Specifically, the advisor:

- Must render financial advice in the ordinary course of its business;
- Must disclose to the person any significant relationship it has with the issuer or any of its affiliates, or with a shareholder proponent of the matter on which advice is given, in addition to any material interest of the advisor in the matter to which the advice relates;
- May not receive any special commission or remuneration for furnishing the proxy voting advice from anyone other than the recipients of the advice; and
- May not furnish proxy voting advice on behalf of any person soliciting proxies.

Even if exempt from the informational and filing requirements of the federal

[238] *See, e.g.,* GAO Report to Congress, Corporate Shareholder Meetings—Issues Relating to Firms That Advise Institutional Investors on Proxy Voting (June 2007) ("GAO Report") at 6–7 (attributing the growth in the use of proxy voting advisers, in part, to the Commission's recognition of fiduciary obligations associated with voting proxies by registered investment advisers and its adoption of the proxy voting Advisers Act Rule 206(4)–6(17 CFR 275.206(4)–6), requiring registered investment advisers to "adopt and implement written policies and procedures that are reasonably designed to ensure that you vote client securities in the best interest of clients, which procedures must include how you address material conflicts that may arise between your interests and those of your clients").

[239] 17 CFR 240.14a–8.

[240] *See* Proxy Voting by Investment Advisers, Release No. IA–2106 (Jan. 31, 2003) at text accompanying note 25 (stating that an adviser could demonstrate that the vote was not a product of a conflict of interest if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party).

[241] *E.g.,* GAO Report, note 238, above, at 1.

[242] For example, The RiskMetrics Group ("RiskMetrics") publishes "governance risk indicators." Information on these ratings is available at *http://www.riskmetrics.com/GRId-info.* Proxy advisory firms are not the only types of businesses that offer corporate governance ratings or scores.

[243] Exchange Act Rule 14a–1(*l*)(iii) [17 CFR 240.14a–1(*l*)(iii)] defines the solicitation of proxies to include "[t]he furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy."

[244] *See* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Release No. 34–16104 (Aug. 13, 1979) at note 25. Of course, the issue of whether or not a particular communication constitutes a solicitation depends both upon the specific nature and content of the communication and the circumstances under which it is transmitted. *See* Broker-Dealer Participation in Proxy Solicitations, Release No. 34–7208 (Jan. 7, 1964).

[245] 17 CFR 240.14a–2(b)(3).

[246] *See* Shareholder Communications and Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Release No. 34–16356 (Nov. 21, 1979) [44 FR 68769]. In 1992, the Commission confirmed that the Rule 14a–2(b)(3) exemption is available to proxy advisory firms that render only proxy voting advice. *See* Regulation of Communications Among Shareholders, Release No. 34–31326 (Oct. 16, 1992) [57 FR 48276], at note 41.

proxy rules, the furnishing of proxy voting advice remains subject to the prohibition on false and misleading statements in Rule 14a–9.[247]

Second, when proxy advisory firms provide certain services, they meet the definition of investment adviser under the Advisers Act and thus are subject to regulation under that Act. A person is an "investment adviser" if the person, for compensation, engages in the business of providing advice to others as to the value of securities, whether to invest in, purchase, or sell securities, or issues reports or analyses concerning securities.[248] As described above, proxy advisory firms receive compensation for providing voting recommendations and analysis on matters submitted for a vote at shareholder meetings. These matters may include shareholder proposals, elections for boards of directors, or corporate actions such as mergers. We understand that typically proxy advisory firms represent that they provide their clients with advice designed to enable institutional clients to maximize the value of their investments. In other words, proxy advisory firms provide analyses of shareholder proposals, director candidacies or corporate actions and provide advice concerning particular votes in a manner that is intended to assist their institutional clients in achieving their investment goals with respect to the voting securities they hold. In that way, proxy advisory firms meet the definition of investment adviser because they, for compensation, engage in the business of issuing reports or analyses concerning securities and providing advice to others as to the value of securities.

The Supreme Court has construed Section 206 of the Advisers Act as establishing a federal fiduciary standard governing the conduct of investment advisers.[249] The Court stated that "[t]he Advisers Act of 1940 reflects a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested."[250] As investment advisers, proxy advisory firms owe fiduciary duties to their advisory clients.

In addition, Section 206 of the Advisers Act,[251] the antifraud provision, applies to any person that meets the definition of investment adviser, regardless of whether that person is registered with the Commission. Section 206(1) of the Advisers Act prohibits an investment adviser from "employ[ing] any device, scheme, or artifice to defraud any client or prospective client."[252] Section 206(2) prohibits an investment adviser from engaging in "any transaction, practice or course of business which operates as a fraud or deceit on any client or prospective client."[253] As we stated recently, the Commission has authority under Section 206(4) of the Advisers Act to adopt rules "reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive or manipulative."[254] Congress gave the Commission this authority to, among other things, address the "question as to the scope of the fraudulent and deceptive activities which are prohibited [by Section 206]," [255] and thereby permit the Commission to adopt prophylactic[256] rules that may prohibit acts that are not themselves fraudulent.[257]

Proxy advisory firms also may have to register with the Commission as investment advisers. Whether a particular investment adviser is required to register with the Commission depends on several factors. Investment advisers are generally prohibited from registering with the Commission if they have less than $25 million in assets under management.[258] Congress established this threshold in 1996 to bifurcate regulatory responsibility between the Commission and the states.[259] The Commission retains authority to exempt advisers from the prohibition on registration if the prohibition would be "unfair, a burden on interstate commerce, or otherwise inconsistent with the purposes" of the prohibition.[260]

Proxy advisory firms are unlikely to have sufficient assets under management to register with the Commission because they typically do not manage client assets.[261] Proxy advisory firms may nonetheless be eligible to register because they qualify for one of the exemptions from the registration prohibition under Rule 203A–2 under the Advisers Act. In particular, some proxy advisory firms

[247] 17 CFR 240.14a–9.

[248] Advisers Act Section 202(a)(11) [15 U.S.C. 80b–2(a)(11)]. Sections 202(a)(11)(A) through (G) of the Advisers Act address exclusions to the definition of the term "investment adviser." [15 U.S.C. 80b–2(a)(11)(A)–(G)].

[249] *Transamerica Mortgage Advisors, Inc.* v. *Lewis,* 444 U.S. 11, 17 (1979); *SEC* v. *Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191–192 (1963).

[250] *Capital Gains,* 375 U.S. at 191–192.

[251] 15 U.S.C. 80b–6.

[252] 15 U.S.C. 80b–6(1).

[253] 15 U.S.C. 80b–6(2).

[254] Political Contributions by Certain Investment Advisers, Advisers Act Release No. 3043 (July 1, 2010) at 16, *citing* 15 U.S.C. 80b–6(4). Section 206(4) was added to the Advisers Act in Pub. L. No. 86–750, 74 Stat. 885, at sec. 9 (1960).

[255] *See* H.R. REP. NO. 2197, 86th Cong., 2d Sess., at 7–8 (1960) (stating that "[b]ecause of the general language of section 206 and the absence of express rulemaking power in that section, there has always been a question as to the scope of the fraudulent and deceptive activities which are prohibited and the extent to which the Commission is limited in this area by common law concepts of fraud and deceit * * * [Section 206(4)] would empower the Commission, by rules and regulations to define, and prescribe means reasonably designed to prevent, acts, practices, and courses of business which are fraudulent, deceptive, or manipulative. This is comparable to Section 15(c)(2) of the Securities Exchange Act [15 U.S.C. 78o(c)(2)] which applies to brokers and dealers."). *See also* S. REP. NO. 1760, 86th Cong., 2d Sess., at 8 (1960) ("This [section 206(4) language] is almost the identical wording of section 15(c)(2) of the Securities Exchange Act of 1934 in regard to brokers and dealers."). The Supreme Court, in *United States* v. *O'Hagan,* interpreted nearly identical language in section 14(e) of the Securities Exchange Act [15 U.S.C. 78n(e)] as providing the Commission with authority to adopt rules that are "definitional and prophylactic" and that may prohibit acts that are "not themselves fraudulent * * * if the prohibition is 'reasonably designed to prevent * * * acts and practices [that] are fraudulent.'" *United States* v. *O'Hagan,* 521 U.S. 642, 667, 673 (1997). The wording of the rulemaking authority in section 206(4) remains substantially similar to that of section 14(e) and section 15(c)(2) of the Securities Exchange Act. *See also* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Advisers Act Release No. 2628 (Aug. 3, 2007) [72 FR 44756] (stating, in connection with the suggestion by commenters that section 206(4) provides us authority only to adopt prophylactic rules that explicitly identify conduct that would be fraudulent under a particular rule, "We believe our authority is broader. We do not believe that the commenters' suggested approach would be consistent with the purposes of the Advisers Act or the protection of investors.").

[256] S. REP. NO. 1760, note 255, above, at 4, 8. The Commission has used this authority to adopt eight rules that address abusive advertising practices, custodial arrangements, the use of solicitors, required disclosures regarding advisers' financial conditions and disciplinary histories, prohibition against political contributions by certain investment advisers ("pay to play"), proxy voting, compliance procedures and practices, and deterring fraud with respect to pooled investment vehicles. 17 CFR 275.206(4)–1; 275.206(4)–2; 275.206(4)–3; 275.206(4)–4; 275.206(4)–5; 275.206(4)–6; 275.206(4)–7; and 275.206(4)–8.

[257] *See* HR. REP. NO. 2197, note 255, above.

[258] Advisers Act Section 203A [15 USC 80b–3(a)]. If such an adviser is an adviser to an investment company registered under the Investment Company Act, however, it must register with the Commission. *See id.*

[259] National Securities Markets Improvement Act of 1996, Pub. L. No. 104–290, 110 Stat. 3416 (codified as amended in scattered sections of the United States Code).

[260] Advisers Act Section 203A(c) [15 U.S.C. 80b–3(c)].

[261] For the purpose of calculating assets under management, an adviser must look to those securities portfolios for which it provides "continuous and regular supervisory or management services." *See* Instruction 5 to Item 5F of Form ADV [17 CFR 279.1].

may be able to rely on the exemption for "pension consultants" [262] if they have pension plan clients with an aggregate minimum value of $50 million.[263]

Proxy advisory firms that are registered as investment advisers with the Commission are subject to a number of additional regulatory requirements that provide important protections to the firm's clients. For example, registered investment advisers have to make certain disclosures on their Form ADV.[264] Among other things, these disclosures include information about arrangements that the adviser has that involve certain conflicts of interest with its advisory client.[265] In addition, proxy advisory firms that are registered investment advisers are required to adopt, implement, and annually review an internal compliance program consisting of written policies and procedures that are reasonably designed to prevent the adviser or its supervised persons from violating the Advisers Act.[266] Every registered proxy advisory firm that is registered as an investment adviser also must designate a chief compliance officer to oversee its compliance program. This compliance officer must be knowledgeable about the Advisers Act and have authority to develop and enforce appropriate compliance policies and procedures for the adviser.[267] A proxy advisory firm that is registered as an investment adviser also is required to establish, maintain, and enforce policies and procedures reasonably designed to prevent the misuse of material non-public information.[268] Proxy advisory firms that are registered as investment advisers also are required to create and preserve certain records that our examiners review when performing an inspection of an adviser.[269]

2. Concerns About the Role of Proxy Advisory Firms

The use of proxy advisory firms by institutional investors raises a number of potential issues. For example, to the extent that conflicts of interest on the part of proxy advisory firms are insufficiently disclosed and managed, shareholders could be misled and informed shareholder voting could be impaired. To the extent that proxy advisory firms develop, disseminate, and implement their voting recommendations without adequate accountability for informational accuracy in the development and application of voting standards, informed shareholder voting may be likewise impaired. Furthermore, some have argued that proxy advisory firms are controlling or significantly influencing shareholder voting without appropriate oversight, and without having an actual economic stake in the issuer.[270] In evaluating any potential regulatory response to such issues, we are interested in learning commentators' views regarding appropriate means of addressing these issues, including the application of the proxy solicitation rules and Advisers Act registration provisions to proxy advisory firms. We are also interested in learning commentators' views as to whether these issues are affected—and if so, how—by the fact that there is one dominant proxy advisory firm in the marketplace, Institutional Shareholder Services ("ISS"),[271] whose long-standing position, according to the Government Accountability Office, "has been cited by industry analysts as a barrier to competition." [272]

In order to address these issues, which we describe in additional detail below, we would like to receive views about the role that proxy advisory firms play in the proxy voting process, which could, for instance, assist in determining whether additional regulatory requirements might be appropriate, such as the extent to which oversight of proxy advisory firms registered as investment advisers might be improved. Below we outline the two principal areas of concern about the proxy advisory industry that have come to our attention.

a. Conflicts of Interest

Perhaps the most frequently raised concern about the proxy advisory industry relates to conflicts of interest.[273] The Government Accountability Office has issued two reports since 2004 examining conflicts of interest in proxy voting by institutional investors.[274] The GAO Report issued in 2007 addressed, among other things, conflicts of interest that may exist for proxy advisory firms, institutional investors' use of the firms' services and the firms' potential influence on proxy vote outcomes, as well as the steps that the Commission has taken to oversee these firms.[275] The GAO Report noted that the most commonly cited conflict of interest for proxy advisory firms is when they provide both proxy voting recommendations to investment advisers and other institutional investors and consulting services to corporations seeking assistance with proposals to be presented to

[262] Advisers Act Rule 203A–2(b) [17 CFR 275.203A–2(b)] provides that "[a]n investment adviser is a pension consultant * * * if the investment adviser provides investment advice to: Any employee benefit plan described in Section 3(3) of the Employee Retirement Income Security Act of 1974 ("ERISA") [29 U.S.C. 1002(3)]; Any governmental plan described in Section 3(32) of ERISA (29 U.S.C. 1002(32); or Any church plan described in Section 3(33) of ERISA (29 U.S.C. 1002(33)."

[263] *See id.* A number of proxy advisory firms are currently registered with the Commission under the pension consultant exemption.

[264] *See* Advisers Act Rule 203–1 [17 CFR 275.203–1]. Form ADV consists of two parts. The information provided by advisers in Part I of that form provides the Commission with census-like information on investment adviser registrants and is critical to the examination program in assessing risk and planning examinations. It also requires investment advisers to report disciplinary events of the adviser and its employees. *See* Advisers Act Rule 204–1 [17 CFR 275.204–1].

[265] Part II of Form ADV, or a brochure containing the information in the Form, is required to be delivered to advisory clients or prospective clients by Rule 204–3 under the Advisers Act [17 CFR 275.204–3]. In addition to the disclosure of certain conflicts of interest, Part II contains information including the adviser's fee schedule and the educational and business background of management and key advisory personnel of the adviser. Part II is currently not submitted to the SEC but must be kept by advisers in their files and made available to the SEC upon request and is "considered filed." *See* Advisers Act Rule 204–1(c) [17 CFR 275.204–1(c)]. Form ADV must be updated at least annually or when there are material changes. *See* Advisers Act Rule 204–1 [17 CFR 275.204–1].

[266] Advisers Act Rule 206(4)–7 [17 CFR 275.206(4)–7].

[267] Advisers Act Rule 206(4)–7(c) [17 CFR 275.206(4)–7(c)].

[268] Section 204A of the Advisers Act [15 U.S.C. 80b–4a].

[269] Advisers Act Rule 204–2 [17 CFR 275.204–2].

[270] *See* comment letters to Release No. 33–9046, note 7, above, from The Business Roundtable and IBM. It has been suggested, for example, that some issuers have adopted corporate governance practices simply to meet a proxy advisory firm's standards, even though they may not see the value of doing so. *See* GAO Report, note 238, above, at 10.

[271] *See* GAO Report, note 238, above, at 13 (stating that, "[a]s the dominant proxy advisory firm, ISS has gained a reputation with institutional investors for providing reliable, comprehensive proxy research and recommendations, making it difficult for competitors to attract clients and compete in the market"). As of June 2007, ISS's client base included an estimate of 1,700 institutional investors, more than the other four major firms combined. Id. ISS was acquired by RiskMetrics in January 2007, which in turn was acquired on June 1, 2010 by MSCI, Inc. *See* "MSCI Completes Acquisition of RiskMetrics," (June 1, 2010), *available* at *http://www.riskmetrics.com/news_releases/20100601_msci.*

[272] GAO Report, note 238, above, at 2.

[273] *See generally* Thompson-Mann Policy Briefing, note 89, above, at 8; GAO Report, note 238, above.

[274] GAO Report, note 238, above. The GAO issued an earlier report in 2004 that described, among other things, conflicts of interest in the proxy voting system with respect to pension plans and actions taken to manage them by plan fiduciaries. *See* GAO, Pension Plans: Additional Transparency and Other Actions Needed in Connection with Proxy Voting (Aug. 10, 2004), *available at http://www.gao.gov/new.items/d04749.pdf.*

[275] GAO Report, note 238, above. That report noted that the Commission had not identified any major violations in its examinations of such firms that were registered as investment advisers.

shareholders or with improving their corporate governance ratings.[276]

In particular, this conflict of interest arises if a proxy advisory firm provides voting recommendations on matters put to a shareholder vote while also offering consulting services to the issuer or a proponent of a shareholder proposal on the very same matter.[277] The issuer in this situation may purchase consulting services from the proxy advisory firm in an effort to garner the firm's support for the issuer when the voting recommendations are made.[278] Similarly, a proponent may engage the proxy advisory firm for advice on voting recommendations in an effort to garner the firm's support for its shareholder proposals. The GAO Report also noted that the firm might recommend a vote in favor of a client's shareholder proposal in order to keep the client's business.

A conflict also arises when a proxy advisory firm provides corporate governance ratings on issuers to institutional clients, while also offering consulting services to corporate clients so that those issuers can improve their corporate governance ranking.[279] The GAO Report also described the potential for conflicts of interest when owners or executives of the proxy advisory firm have significant ownership interests in, or serve on the board of directors of, issuers with matters being put to a shareholder vote on which the proxy advisory firm is offering vote recommendations. In such cases, institutional investors told the GAO that some proxy advisory firms would not offer vote recommendations to avoid the appearance of a conflict of interest.

It is our understanding that at least one proxy advisory firm provides a generic disclosure of such conflicts of interest by stating that the proxy advisory firm "may" have a consulting relationship with the issuer, without affirmatively stating whether the proxy advisory firm has or had a relationship with a specific issuer or the nature of any such relationship. Some have argued that this type of general disclosure is insufficient, even if the proxy advisory firm has confidentiality walls between its corporate consulting and proxy research departments.[280]

b. Lack of Accuracy and Transparency in Formulating Voting Recommendations

Some commentators have expressed the concern that voting recommendations by proxy advisory firms may be made based on materially inaccurate or incomplete data, or that the analysis provided to an institutional client may be materially inaccurate or incomplete.[281] To the extent that a voting recommendation is based on flawed data or analysis, issuers have expressed a desire for a process to correct the mistake. We understand, however, that proxy advisory firms may be unwilling, as a matter of policy, to accept any attempted communication from the issuer or to reconsider recommendations in light of such communications. Even if a proxy advisory firm entertains comment from the issuer and amends its recommendation, votes may have already been cast based on the prior recommendation. Accordingly, some issuers have expressed a desire to be involved in reviewing a draft of the proxy advisory firm's report, if only for the limited purpose of ensuring that the voting recommendations are based on accurate issuer data. Some proxy advisory firms have claimed that they are willing to discuss matters with issuers, but that some issuers are unwilling to enter into such discussions.

There also is a concern that proxy advisory firms may base their recommendation on one-size-fits-all governance approach.[282] As a result, a policy that would benefit some issuers, but that is less suitable for other issuers, might not receive a positive recommendation, making it less likely to be approved by shareholders.

Rule 14a–2(b)(3)'s exemption of proxy advisory firms does not mandate that a firm relying on the exemption have specific procedures in place to ensure that its research or analysis is materially accurate or complete prior to recommending a vote.[283] While voting advice by firms relying on the Rule 14a–2(b)(3) exemption remains subject to the antifraud provisions of the proxy rules contained in Rule 14a–9[284]—and those antifraud provisions should deter the rendering of voting advice that is misleading or inaccurate—it is our understanding that certain participants in the proxy process believe that additional oversight mechanisms could improve the likelihood that voting recommendations are based on materially accurate and complete information. In addition, as a fiduciary, the proxy advisory firm has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information.

3. Potential Regulatory Responses

a. Potential Solutions Addressing Conflicts of Interest

Revising or providing interpretive guidance on the proxy rule exemption in Exchange Act Rule 14a–2(b)(3)[285] could be one potential solution to the concerns regarding a proxy advisory firm's disclosures about conflicts of interest. Exchange Act Rule 14a–2(b)(3)(ii) requires that a person furnishing proxy voting advice to another person must disclose to its client "any significant relationship" it has with the issuer, its affiliates, or a shareholder proponent of the matter on which advice is given. It appears that some proxy advisory firms currently provide disclosure limited to the fact that the firm "may" provide consulting

[276] In its report, GAO described the business model of ISS as containing this particular conflict and noted that the proxy advisory firm took steps to manage the conflict by disclosing the relationships it had with corporate governance clients and implementing policies and procedures to separate its consulting services from proxy voting services. *See* GAO Report, note 238, above, at 10–11. These potential conflicts of interest of proxy advisory firms are not limited to the United States. *See* OECD Survey, note 90, above (expressing concern about the integrity of financial intermediaries and the need for more concrete rules).

[277] *See* GAO Report, note 238, above. Not all proxy advisory firms provide both types of services; some proxy advisory firms differentiate their services by not providing consulting services to corporations. *See http://www.ejproxy.com/about.aspx; http://www.glasslewis.com/solutions/proxypaper.php;* and *www.marcoconsulting.com/2.3.html.*

[278] *See* Thompson-Mann Policy Briefing, note 89, above, at 9. *See also* comment letter to Proxy Disclosure and Solicitation Enhancements, Release No. 33–9052 (July 10, 2009) [74 FR 35076], from Pearl Meyer and Partners, at 12.

[279] *See* Paul Rose, *The Corporate Governance Industry*, 32 Iowa J. Corp. L. 887, 903 (2007).

[280] *See generally* comment letter to Release No. 33–9052, note 278, above, from Oppenheimer Funds.

[281] *See, e.g.,* White Paper on RiskMetrics Report on Target Corporation, *available at http://tgtfiles.target.com/empl/pdfs/RMG_Analysis.pdf* (identifying asserted inaccurate or misleading statements or assessments in RiskMetrics' report on the 2009 proxy contest involving Target Corporation); Matthew Greco, "New, New Ranking of the Shareholder Friendly, Unfriendly," Securities Data Publishing, May 13, 1996.

[282] The concern regarding a potential one-size-fits-all approach to proxy advice is not limited to U.S. proxy participants. The OECD also has expressed concern that there is a danger of one-size-fits-all voting advice (*e.g.*, applicable to compensation and a box-ticking approach by shareholders minimizing analysis and responsibilities of shareholders) so that a competitive market for advice needs to be encouraged. *See* OECD, Corporate Governance and the Financial Crisis: Key Findings and Main Messages (June 2009), *available at http://www.oecd.org/dataoecd/3/10/43056196.pdf.*

[283] 17 CFR 240.14a–2(b)(3).

[284] 17 CFR 240.14a–9.

[285] 17 CFR 240.14a–2(b)(3).

or other advisory services to issuers. However, we believe that such disclosure should be examined further to determine whether it adequately indicates to shareholders the existence of a potential conflict with respect to any particular proposal. Therefore, we are interested in receiving views on whether this rule should be revised or whether we should provide additional guidance regarding the requirements of this rule. Specifically, we could revise the rule to require more specific disclosure regarding the presence of a potential conflict.

Alternatively, or in addition, we seek comment on whether proxy advisory firms operate the kind of national business or have an impact on the securities markets that Advisers Act Section 203A(c) [286] was designed to address, and whether, as a result, we should establish an additional exemption from the prohibition on federal registration for proxy advisory firms to register with the Commission as investment advisers. We could also provide additional guidance, if necessary, on the fiduciary duty of proxy advisors who are investment advisers to deal fairly with clients and prospective clients, and to disclose fully any material conflict of interest. We also could provide guidance or propose a rule requiring specific disclosure by proxy advisory firms that are registered as investment advisers regarding their conflicts of interest, including, for example, on Form ADV.

Finally, in light of the similarity between the proxy advisory relationship and the "subscriber-paid" model for credit ratings, we could consider whether additional regulations similar to those addressing conflicts of interest on the part of Nationally Recognized Statistical Rating Organizations ("NRSROs") [287] would be useful responses to stated concerns about conflicts of interest on the part of proxy advisory firms. For example, such regulations could prohibit certain conflicts of interest and require proxy advisory firms to file periodic disclosures, akin to Form NRSRO, describing any conflicts of interest and procedures to manage them.

b. Potential Solutions Addressing Accuracy and Transparency in Formulating Voting Recommendations

We have identified a number of potential approaches that might address concerns about accuracy or transparency in the formulation of voting recommendations by proxy advisory firms. For example, proxy advisory firms could provide increased disclosure regarding the extent of research involved with a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data. Proxy advisory firms could also disclose policies and procedures for interacting with issuers, informing issuers of recommendations, and handling appeals of recommendations.[288] We could also consider requiring proxy advisory firms to file their voting recommendations with us as soliciting material, at least on a delayed basis, to facilitate independent evaluation by market participants of the quality of those recommendations.

3. Request for Comment

As discussed above, we are considering the extent to which the voting recommendations of proxy advisory firms serve the interests of investors in informed proxy voting, and whether, and if so, how, we should take steps to improve the utility of such recommendations to investors. In particular, we seek comment on whether we should clarify existing regulations or propose additional regulations to address concerns about the existence and disclosure of conflicts of interest on the part of proxy advisory firms, and about the accuracy and transparency of the formulation of their voting recommendations. Accordingly, we seek commentators' views generally on proxy advisory firms and invite comment on the following questions:

- Do proxy advisory firms perform services for their clients in addition to or different from those noted above?
- Is additional regulation of proxy advisory firms necessary or appropriate for the protection of investors? Why or why not? If so, what are the implications of regulation through the Advisers Act or the proxy solicitation rules under the Exchange Act? Are any other regulatory approaches equally or better suited to provide appropriate additional regulation? Are there regulatory approaches used in connection with NRSROs that may be appropriate to consider applying to proxy advisory firms?
- Are there conflicts of interest (other than those described above) when a proxy advisory firm provides services to both investors, including shareholder proponents, and issuers? If so, are those conflicts appropriately addressed by current laws, regulations, and industry practices?
- Are there conflicts of interest where a proxy advisory firm is itself a publicly held company? If so, what are they and how should they be addressed?
- What policies and procedures, if any, do proxy advisory firms use to ensure that their voting recommendations are independent and not influenced by the fees they receive for services to corporate clients or shareholder proponent clients?
- Is the disclosure that proxy advisory firms currently provide to investor clients regarding conflicts of interest adequate? Would specific disclosure of potential conflicts and conflict of interest policies be sufficient, or is some other form of regulation necessary (*e.g.*, prohibiting such conflicts)?
- Do issuers modify or change their proposals to increase the likelihood of favorable recommendations by a proxy advisory firm?
- Do issuers adopt particular governance standards solely to meet the standards of a proxy advisory firm? If so, why do issuers behave in this manner?

[286] 15 U.S.C. 80b–3a(c).

[287] NRSROs are credit rating agencies that assess the creditworthiness of obligors as entities or with respect to specific securities or money market instruments and that have elected to be registered with the Commission under Section 15E of the Exchange Act. 15 U.S.C. 78o–7. Sections 15E and 17 of the Exchange Act provide the Commission with exclusive authority to implement registration, recordkeeping, financial reporting, and oversight rules with respect to NRSROs. 15 U.S.C. 78o–7 and 78q.

One commentator has suggested that the Commission's rules that govern NRSROs may be useful templates for developing a regulatory program addressing conflicts of interest and other issues with respect to the accuracy and transparency of voting recommendations provided by proxy advisory firms. Such rules include provisions that: (i) Require rating actions to be made publicly available on the NRSRO's Internet Web site [17 CFR 240.17g–2(d)(3)]; (ii) prohibit certain conflicts of interest [17 CFR 240.17g–5(c); Form NRSRO Exhibits 6–7]; (iii) require the disclosure and management of certain other conflicts of interest that arise in the normal course of engaging in the business of issuing credit ratings [17 CFR 240.17g–5(b)]; and (iv) require disclosure of, among other things, performance measurement statistics, sources of information, models and metrics used, qualifications and compensation of analysts, and procedures and methodologies used to determine credit ratings, including procedures for (A) interacting with management of rated issuers, (B) informing issuers of rating decisions, and (C) appealing final or pending rating decisions. [Form NRSRO, Exhibits 1, 2, 8 and 13]. We recognize that the role of NRSROs and proxy advisory firms differ and that following a similar regulatory approach might not be appropriate. We also recognize that the costs and benefits of the NRSRO regulation differ from the costs and benefits of potential additional regulation of proxy advisory firms.

[288] *See, e.g.,* Thompson-Mann Policy Briefing, note 89, above, at 25 (advocating that a proxy advisory firm should, where feasible and appropriate, prior to issuing or revising a recommendation, advise the issuer of the critical information and principal considerations upon which a recommendation will be based and afford the issuer an opportunity to clarify any likely factual misperceptions).

• Should proxy advisory firms be required to disclose publicly their decision models for approval of executive compensation plans? Would this alleviate concerns regarding potential conflicts of interest when issuers pay consulting fees for access to such models?

• What is the competitive structure of the market for proxy advisory firms, and what are the reasons for it? Does competition vary across the types of services provided by the proxy advisory firms or the subset of issuers that they cover? Does the industry's competitive structure affect the quality of the recommendations? If there is, as we understand it, one proxy advisory firm that has a significantly larger market share than other firms,[289] does that affect the quality of the recommendations made by that proxy advisory firm or by other proxy advisory firms? Are there any other effects caused by the fact that there is one dominant proxy advisory firm?

• How do institutional investors use the voting recommendations provided by proxy advisory firms? What empirical data exists regarding how, and to what extent, institutional investors vote consistently, or inconsistently, with such recommendations?

• What criteria and processes do proxy advisory firms use to formulate their recommendations and corporate governance ratings? Does the lack of a direct pecuniary interest in the effects of their recommendations on shareholder value affect how they formulate recommendations and corporate governance ratings? Would greater disclosure about how recommendations and corporate governance ratings are generated and how voting recommendations are made affect the quality of the ratings and the recommendations?

• Are existing procedures followed by proxy advisory firms sufficient to ensure that proxy research reports provided to investor clients are materially accurate and complete? If not, how should proxy advisory firms be encouraged to provide investors with the information they need to make informed voting decisions?

• If additional oversight is needed, should it be in the form of regulatory oversight or issuer involvement? Would requiring delayed public disclosure of voting recommendations be an appropriate means to promote accurate voting recommendations?

• Do proxy advisory firms control or significantly influence shareholder voting without appropriate oversight? If so, is there empirical evidence that demonstrates this control or significant influence? If such proxy advisory firms do control or significantly influence shareholder voting, is that inappropriate, and if so, should the Commission take action to address it? If so, what specific action should the Commission take?

• Are there any proxy advisory firms that cannot rely on an exemption to the prohibition on Advisers Act registration? If so, why do the exemptions not apply to those proxy advisory firms?

• Do proxy advisory firms operate the kind of national business that the Advisers Act Section 203A(c) was designed to address? Should we create an additional exemption from the prohibition on federal registration for proxy advisory firms to register as investment advisers? If so, what standard should we use?

• Do the current regulatory requirements for registered investment advisers adequately address advisers whose business is primarily providing proxy voting services? If we consider new rulemaking in this area, what should the rules address? Should we amend Form ADV to require specific disclosures by registered investment advisers that are proxy advisory firms?

• Do proxy advisory firms maintain an audit trail for votes cast on behalf of clients? Do proxy advisory firms monitor whether votes cast are appropriately counted, and if so, how?

B. Dual Record Dates

1. Background

Under state corporation law, issuers set a record date in advance of a shareholder meeting, and holders of record on the record date are entitled to notice of the meeting and to vote at the meeting. State corporation law also governs how far in advance of the meeting a record date can be—typically, no more than 60 days before the date of the meeting.[290] The record date that an issuer selects has implications under the federal securities laws. Our rules require issuers that have a class of securities registered under Section 12 of the Exchange Act and certain investment companies to provide either proxy materials or an information statement to every investor of the class entitled to vote.[291] Additionally, Rule 14a–13 requires that if an issuer intends to solicit proxies for an upcoming meeting and knows that its securities are held by securities intermediaries, it generally must make an inquiry of each such securities intermediary at least 20 business days prior to the record date to ascertain the number of copies of sets of proxy materials needed to supply the materials to the beneficial owners.[292]

Historically, the same record date has been used for determining both which shareholders are entitled to notice of an upcoming meeting and which shareholders are entitled to vote. However, some states are enacting changes to this procedure. For example, effective August 1, 2009, the Delaware General Corporation Law permits, but does not require, Delaware corporations to use separate record dates for making these two determinations.[293] One important result of this change is that it potentially allows an issuer, by establishing a voting record date close to the meeting date, to decrease the likelihood that as of the meeting date persons entitled to vote at the meeting (*i.e.,* the holders on the voting record date) will no longer have an economic interest in the issuer.[294]

2. Difficulties in Setting a Voting Record Date Close to a Meeting Date

Although Delaware's amended statute permits a voting record date[295] to be as

[289] GAO Report, note 238, above, at 13 (describing ISS as "the dominant proxy advisory firm").

[290] *See, e.g.,* Del. Code Ann. tit. 8, § 213(a) ; Model Bus. Corp. Act § 7.05.

[291] Additionally, Section 402.04 of the NYSE Listed Issuer Manual provides that "[a]ctively operating issuers are required to solicit proxies for all meetings of shareholders," and NASDAQ Listing Rule 5620(b) provides that "[e]ach Issuer that is not a limited partnership shall solicit proxies and provide proxy statements for all meetings of Shareholders."

[292] 17 CFR 240.14a–13. Rule 14c–7 contains a parallel requirement for issuers intending to distribute information statements. 17 CFR 240.14c–7.

[293] Del. Code Ann. tit. 8, § 213(a). Section 213 provides that the record date for determining which shareholders are entitled to notice of a meeting "shall not be more than 60 nor less than 10 days before the date of such meeting," and that Unless the board determines otherwise, "such date shall also be the record date for determining the stockholders entitled to vote at such meeting." The August 1, 2009 amendment provides that as an alternative, the board may determine "that a later date on or before the date of the meeting shall be the date for making such determination." Recently proposed amendments to the Model Business Corporation Act, especially § 7.07(e) of that Act, adopt a similar approach in permitting dual record dates. *See* Changes in the Model Business Corporation Act—Proposed Amendments to Shareholder Voting Provisions Authorizing Remote Participation in Shareholder Meetings and Bifurcated Record Dates, 65 Bus. Law. 153, 156–160 (Nov. 2009).

[294] *See* James L. Holzman and Paul A. Fioravanti, Jr., "Review of Developments in Delaware Corporation Law," Apr. 2009, at 2, *available at http://www.prickett.com/PrinterFriendly/Articles/2009_Review_of_Developments.pdf* (explaining that the ability to move the voting record date closer to meeting date should promote voting only by those who continue to have an economic interest).

[295] For purposes of this release, the term "voting record date" refers to the date used in determining

late as the date of the meeting itself,[296] certain logistical and legal matters currently prevent issuers from setting such a voting record date.[297] For example, Rule 14c–2(b) requires that if information statements are being distributed, they must be sent or given to holders of the class of securities entitled to vote at least 20 calendar days prior to the meeting date. Because the investors entitled to receive the information statements, by definition, cannot be identified until the voting record date,[298] issuers intending to distribute information statements currently would be unable to set a voting record date that is fewer than 20 calendar days prior to the corresponding meeting.

We have not adopted a 20 calendar day requirement with respect to proxy materials,[299] but we have stated that "the materials must be mailed sufficiently in advance of the meeting date to allow five business days for processing by the banks and broker-dealers and an additional period to provide ample time for delivery of the material, consideration of the material by the beneficial owners, return of their voting instructions, and transmittal of the vote from the bank or broker-dealer to the tabulator." [300] Additionally,

- Instructions to Schedule 14A, Form S–4, and Form F–4 prescribe certain situations in which, if the materials being sent to shareholders incorporate information by reference, the issuer must send its proxy statement or prospectus to investors at least 20 business days before the meeting; [301]
- Rule 14a–16(a)(1) requires issuers not relying on the full set delivery option to provide a Notice of Internet Availability of Proxy Materials at least 40 calendar days before the meeting date; [302] and
- Certain of our rules and forms require that if a limited partnership roll-up transaction is being proposed, the disclosure document must be distributed no later than the lesser of 60 calendar days prior to the meeting date or the maximum number of days permitted for giving notice under applicable state law.[303]

Because these provisions require a period of time between the mailing of materials and the meeting date and because, under a dual record date system, the investors to whom the materials must be mailed (that is, those investors entitled to vote at the meeting) would not be identified until the voting record date,[304] issuers are limited in how close to the meeting date their voting record date can be.

Issuers also need to consider logistical matters in deciding the timing of their voting record date and their mailing. They need to find out how many copies of their materials to print, print the materials, and distribute the materials to transfer agents and to proxy service providers so that they can be delivered to registered and beneficial owners. Exchange Act Rules 14a–13, 14b–1, 14b–2, and 14c–7 govern this process, but we understand that in practice those rules reflect only a subset of the time-consuming logistical hurdles issuers need to go through. In this release, we are inviting submission of additional information on this process and suggestions for streamlining it.

3. Potential Regulatory Responses

In light of the changes to state law, we seek to explore whether to propose action to accommodate issuers that wish to use separate record dates where permitted by state law, and if so, what action we should take. In analyzing this situation, we are faced with competing considerations. On one hand, the closer to a meeting date a voting record date is, the more likely it is that investors who are entitled to vote will still have an economic interest in the issuer at the time of the shareholder meeting. Thus, setting the voting record date close to the meeting date avoids disenfranchising the shareholders who purchase their shares after the record date for notice of the meeting. Moreover, facilitating the use of a notice record date that significantly precedes a voting record date may assist shareholders in recalling loaned securities in order to vote them. On the other hand, investors who are entitled to vote need adequate time to receive the proxy materials and consider the matters presented to them for approval. Inadequate time can lead to uninformed voting decisions or, in some cases, a decision by the investor not to vote at all, a problem that was highlighted in 2007 as we considered adopting the notice and access rules.[305]

If we choose to facilitate issuers' use of separate record dates, we could choose between two general models, one focusing principally on the notice record date and the other focusing principally on the voting record date. The first model would be to require issuers to provide proxy materials or an information statement, as applicable, to those who are investors as of the notice record date. This model parallels the Delaware provision in that it focuses the information-delivery obligation on persons who are investors as of the notice record date. One open question under this first model is whether issuers should subsequently be obligated to send the disclosure document to those who were not investors as of the notice record date but who become investors by the voting record date.[306]

The second model would be to require issuers to provide the disclosure document to those who are investors as of the voting record date. An open issue under this model is whether and how issuers should be obligated to make the disclosure document public at some point before the voting record date.

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the stockholders entitled to vote at the meeting, and the term "notice record date" refers to the date used for determining the stockholders entitled to notice of the meeting. "Voting-record-date shareholders" and "notice-record-date shareholders" refer to shareholders who hold their shares as of the record date that is specified.

[296] *See* Charles M. Nathan, "'Empty Voting' and Other Fault Lines Undermining Shareholder Democracy: The New Hunting Ground for Hedge Funds," *available at http://lw.com/upload/pubContent/_pdf/pub1878_1.Commentary.Empty.Voting.pdf* (explaining that, "[w]ith modern technology, there is no apparent need to retain an advance record date concept to manage shareholder voting. Rather, the record date could be as late as the close of business on the night preceding the meeting, with a voting period (*i.e.*, the time for which the polls remain open) at or in conjunction with the meeting lasting several hours or perhaps a full working day.").

[297] Conversely, the record date for traded companies in the United Kingdom must be set at a time that is not more than 48 hours before the time for the holding of the meeting. The Companies (Shareholders' Rights) Regulations 2009 No. 1632 (Regulation 20, section 360B), *available at http://www.opsi.gov.uk/si/si2009/uksi_20091632_en_3#pt3-l1g9*.

[298] Rules 14a–1(h) and 14c–1(h) define "record date" as "the date as of which the record holders of securities entitled to *vote* at a meeting or by written consent or authorization shall be determined" (emphasis added).

[299] We note, however, that Section 401.03 of the NYSE Listed Issuer Manual "recommends that a minimum of 30 days be allowed between the record and meeting dates so as to give ample time for the solicitation of proxies."

[300] Release No. 34–33768, note 4, above.

[301] *See* Note D.3 to Schedule 14A, General Instruction A.2 to Form S–4, and General Instruction A.2 to Form F–4.

[302] 17 CFR 240.14a–16(a)(1).

[303] Section 14(h)(1)(J) of the Exchange Act, Rule 14a–6(*l*), Rule 14c–2(c), General Instruction I.2 to Form S–4, and General Instruction G.2 to Form F–4.

[304] Under our rules, the issuer must send an information statement to all shareholders entitled to vote at a meeting, but from whom no proxy is being solicited. 17 CFR 240.14c–2. Thus, the issuer effectively must send either a proxy statement or an information statement to any shareholder entitled to vote at a meeting, including those that acquire the securities after the notice record date, but before the voting record date.

[305] *See* Release 34–55146, note 199, above, at note 25.

[306] The theory for not imposing this requirement would be that voting-record-date shareholders will have the information available to them if they desire to see it. The information will be available on the Internet pursuant to Rule 14a–16(b)(1) and (d), and in many cases press releases and media reports would publicize the availability of the information.

Under either model, it is possible that some investors will obtain a proxy card or VIF, fill it out and submit it, and then buy additional shares or sell some shares, all prior to the voting record date. Thus, the number of shares held at the time of submission of the proxy or VIF may differ from the number of shares that are ultimately voted on behalf of the investor. In such a situation, we would need to consider how the proxy or VIF already submitted by the investor would be affected, as well as the legal and operational implications that this situation may impose on broker-dealers and their customers and the costs associated with developing a process to address it, in light of the complex beneficial ownership structure described earlier in this release.

Investors may benefit from receiving information about the effect that trades subsequent to the submission of their proxy or VIF will have on their voting rights. Therefore, additional disclosure may be necessary in proxy and information statements. One possible disclosure would be to establish that if an investor submits a proxy or VIF prior to the voting record date, all of the shares held by the investor as of the voting record date would be voted in accordance with the proxy or VIF, in the absence of specific contrary instructions from the investor.[307] Another alternative would be to clarify that a proxy or VIF would not be used to vote more shares than the investor held at the time he or she submitted the proxy or VIF, so that shares acquired after the notice record date would not be voted unless that investor submits a separate proxy or voting instruction for those shares. However, it appears that each of these approaches may risk undermining the purpose of facilitating a voting record date that is closer to the meeting date.

4. Request for Comment

- Do issuers wish to use dual record dates? If so, why?
- The Delaware amendment became effective on August 1, 2009. Should we first see how popular the dual-record-date provision is before providing a regulatory response? Or, are our rules an impediment to using dual record dates, so that it is difficult to assess whether this new approach would be viewed favorably by issuers or investors unless we change our rules?
- In view of the competing policy considerations described above, if we respond, should we respond in a way that generally facilitates issuers' ability to use the dual-record-date approach or in a way that discourages it? Which direction would be better for investors? Is there a more neutral approach that would better serve the interests of investors?
- Even if it is too early for us to take action that either facilitates or discourages issuers' use of dual record dates, does the mere existence of a two-record-date regime create confusion or uncertainty in the interpretation of any of our existing rules? If so, which rules need to be clarified or revised? For example, should we consider proposing to clarify or to revise:
- Rules 14a–1(h) and 14c–1(h), which define "record date" as, essentially, the voting record date;
- Item 6(b) of Schedule 14A, which requires issuers to "[s]tate the record date, if any, with respect to this solicitation"; or
- Rules 14a–13(a)(3) and 14c–7(a)(3), which require issuers to send an inquiry at least 20 business days prior to the record date?
- Would any SRO rules or recommendations need to be revised or clarified in order to facilitate the use of dual record dates?
- Under the first model described above, after an issuer distributes its disclosure document to investors as of the notice record date, the issuer might need to send the disclosure document, or at least a notice of the availability of the disclosure document, to those who become investors after the notice record date but before the voting record date.
- Would this obligation be appropriate?
- If not, how would new investors obtain the means to vote, such as a proxy card, a VIF, or a control number to vote electronically or telephonically? Would they be limited to attending the meeting in person? Would new beneficial owners be able to vote or attend at all?
- Given that the investors who are entitled to vote are the investors as of the voting record date, would the first model (in which some investors who ultimately would not be entitled to vote would receive proxy materials) serve any useful interest if such an obligation were not imposed?
- If we do not impose such an obligation on issuers, should they be able to choose which new investors to send the disclosure document to, or should an "all or none" requirement apply? If they should have a choice, on what basis should they be able to choose?
- Finally, what impact would the first model have on the costs of distributing proxy materials?
- Under the second model described above, because the voting record date might be close to, or on, the meeting date, would it be necessary to require issuers to make public their disclosure document at some point before the voting record date? What would be the most appropriate way for them to do so, and how far in advance of the voting record date or the meeting date should they be required to do so? Should we consider different requirements for different sizes of issuers (for example, permit more reliance on media outlets and less reliance on physical mailings for larger issuers)?
- Which of the two general approaches outlined above is more appropriate? What other general approaches should we consider?
- Would broker-dealers be able, or have sufficient time, to track accurately which beneficial owners would have the right to vote on the voting record date if it is close to the shareholder meeting? If so, what would be the cost to broker-dealers to establish such tracking systems?
- As discussed above, some of our rules specify a minimum number of days before a meeting by which an issuer must distribute its disclosure document. Should we consider shortening or eliminating any of these time periods? If we shorten any of them, what is an appropriate amount of time to replace it with?
- Should we propose to specify a minimum number of days that must elapse between the mailing of a proxy statement and a meeting, as Rule 14c-2(b) does with information statements? If we were to do so, what would be an appropriate number of days, and should the number be flexible to account for such possibilities as overnight or electronic delivery, or electronic or telephonic voting?[308] In what ways can or should we rely on technology to reduce these time periods?
- Should we propose that federal proxy rules prescribe a form of proxy that permits the shareholder to specify the extent to which an executed proxy should be applied to shares that are bought after the proxy is submitted and before the voting record date?

[307] The investor would, of course, continue to be able to revise his or her previous votes prior to the meeting.

[308] The OECD recommends that measures should be taken, both by regulators and by all the institutions involved in the voting chain (issuers, custodians, *etc.*) to remove obstacles and to encourage the use of flexible voting mechanisms such as electronic voting. Corporate Governance and the Financial Crisis—Key Findings and Main Messages, note 282, above.

• Would voting all of the shares in accordance with the instructions on the proxy or VIF present issues under Rule 14a–10(b), which prohibits the solicitation of "any proxy which provides that it shall be deemed to be dated as of any date subsequent to the date on which it is signed by the security holder"? If so, should that rule be amended, and how?

C. "Empty Voting" and Related "Decoupling" Issues

1. Background and Reasons for Concern

As noted in the Introduction, this release primarily focuses on whether the U.S. proxy system operates with the accuracy, reliability, transparency, accountability, and integrity that shareholders and issuers should rightfully expect. These expectations are shaped in part by the Commission's proxy solicitation, disclosure and other rules, the rules of the national securities exchanges, as well as by the substantive rights granted under state corporate law and the charter and bylaw provisions of individual corporations.

At their core, these expectations are based on the foundational understanding that, absent contractual or legal provisions to the contrary, a "shareholder" possesses both voting rights and an economic interest in the company.

The ability to separate a share's voting rights from the economic stake through, for instance, what has been dubbed "empty voting" and "decoupling" challenges this foundational understanding.[309] The term "empty voting" has been defined to refer to the circumstance in which a shareholder's voting rights substantially exceed the shareholder's economic interest in the company.[310] In this circumstance, the exercise of the right to vote is viewed as "empty" because the votes have been emptied of a commensurate economic interest in the shares (and, at the extreme, may even be associated with a negative economic interest in the sense of benefiting from a decline in the share price). Here, the bundle of rights and obligations customarily associated with share ownership has been "decoupled." Empty voting is an example of decoupling and can occur in a variety of ways, some of which we describe briefly below.

Such decoupling raises potential practical and theoretical considerations for voting of shares. For example, an empty voter with a negative economic interest in the company may prefer that the company's share price fall rather than increase. Such a person's voting motivation contradicts the widely-held assumption that equity securities are voted based on an interest in increasing shareholder value and in a way to protect shareholders' interests or enhance the value of the investment in the securities. That assumption—a core premise of state statutes requiring shareholder votes to elect directors and approve certain corporate decisions—may be undermined by the possibility that persons with voting power may have little or no economic interest or, even worse, have a negative economic interest in the shares they vote. It is a source of some concern that elections of directors and other important corporate actions, such as business combinations, might be decided by persons who could have the incentive to elect unqualified directors or block actions that are in the interests of the shareholders as a whole. Significant decoupling of voting rights from economic interest could potentially undermine investor confidence in the public capital markets.[311]

On the other hand, empty voting may not always be contrary to the interests of shareholders. One article argues, for instance, that informed investors[312] could potentially improve electoral outcomes through empty voting by taking long economic positions, acquiring disproportionate voting power from less informed shareholders,[313] and casting votes that are more informed and thus more likely to contribute to shareholder value.[314]

As discussed below, regardless of whether empty voting is deemed to be "good" or "bad," there is a strong argument for ensuring that there is transparency about the use of empty voting. If a voter acquires shares with a view to influencing or controlling the outcome of a vote but takes steps to reduce the risk of economic loss or even achieve a negative economic interest, disclosure of the empty voter's status and intentions could be important information to other shareholders.[315]

The Commission needs to further evaluate empty voting and related techniques in order to properly review the reliability, accuracy, transparency, accountability, and integrity of the current proxy system and the challenges that may be posed by empty voting and related techniques. Therefore, we are seeking information on the myriad ways in which decoupling can occur, and its nature, extent, and effects on shareholder voting and the proxy process.[316] We understand that responses explicitly intended to address aspects of empty voting have already

[309] *See,* e.g., Henry T. C. Hu & Bernard Black, *Equity and Debt Decoupling and Empty Voting II: Importance and Extensions,* 156 University of Pennsylvania Law Review 625–739 (2008) [hereinafter, *Hu & Black, Empty Voting II*]; Henry T. C. Hu & Bernard Black, *Debt, Equity, and Hybrid Decoupling: Governance and Systemic Risk Implications,* 14 European Financial Management 663–709 (2008) [hereinafter *Hu and Black, Debt and Hybrid Decoupling*]. Henry Hu currently serves as the Director of the Division of Risk, Strategy, and Financial Innovation at the Commission.

[310] For the purposes of this release, empty voting does not include dual class or similar share structures in which the corporate charter prescribes disproportionate allocation of voting and economic rights, albeit in a fully disclosed fashion. Likewise, for purposes of this release empty voting does not encompass the situation in which the individuals within an institutional investor who determine that investor's voting decisions act independently of the person or persons making economic investment decisions in regard to the security being voted. *See, e.g.,* Charles M. Nathan & Parul Mehta, The Parallel Universes of Institutional Investing and Institutional Voting (Mar. 6, 2010), *available at http://www.lw.com/upload/pubContent/_pdf/pub3463_1.pdf; cf.* James McRitchie, Parallel Universes Undercuts Its Own Arguments (Apr. 16, 2010), *available at http://corpgov.net/wordpress/?tag=nathan.* Unlike the dual class situation, this latter situation could involve undisclosed decoupling of voting decisions from economic considerations.

[311] For an academic analysis of many of the efficiency-related effects of equity decoupling, positive as well as negative, *see Hu & Black, Debt and Hybrid Decoupling,* note 309, above, at 667–672. For a discussion of how outsiders as well as incumbent management (e.g., managers, controlling shareholders, and corporations themselves) may try engaging in equity decoupling strategies, *see Hu & Black, Empty Voting II,* note 309, above, at 628–654 and 661–681.

[312] We do not express an opinion as to whether any particular class of investor will always make a shareholder-maximizing vote. For purposes of this discussion, it is sufficient to assume that, generally speaking, a highly informed investor is more likely to vote in a manner that will add to shareholder value than a less informed investor.

[313] Notably, the nature of the decoupling in these circumstances is qualitatively different than that in which a person holding the right to vote has no economic interest, or a negative economic interest, in the issuer. Rather, such an investor has a positive economic interest, and while there is decoupling insofar as that investor holds voting rights that derive from shares owned by a different investor, that investor has voting interests that are aligned with the economic interest of investors generally.

[314] *See* Susan E. K. Christoffersen, Christopher C. Geczy, David K. Musto, and Adam V. Reed, *Vote Trading and Information Aggregation,* Journal of Finance, Vol. 62, 2007, pp. 2897–2929.

[315] Item 6 of Schedule 13D requires disclosure of contracts, arrangements, understandings, or relationships with respect to the securities covered by the Schedule, but the filing of Schedule 13D is triggered only when a person owns greater than 5% of a Section 12-registered equity security, as such ownership is calculated according to the pertinent rules.

[316] Separately, as described in Section V.C.2.b, below, the staff has initiated a project to review longstanding requirements as to disclosure of holdings of securities. The information gathered in connection with both projects, as well as any rule changes that may flow from such projects, could be helpful to the Commission, as well as to shareholders, issuers and state legislatures.

started to occur at the state corporate law and individual corporation level.[317]

2. Empty Voting Techniques and Potential Downsides

a. Empty Voting Using Hedging-Based Strategies

A variety of techniques can be used to accomplish empty voting. One technique is to hold shares but to hedge the economic interest in those shares. A shareholder could hedge that economic interest in a wide variety of ways, including by buying either exchange-traded or OTC put options. In a recent Commission enforcement action, a registered investment adviser agreed to settle charges that it had violated Section 13(d) of the Exchange Act in furtherance of a strategy of "essentially buying votes."[318] The investment adviser purchased shares of a prospective acquirer "for the exclusive purpose of voting the shares in a merger and influencing the outcome of the vote" on a proposed acquisition of a company in which the investment adviser owned a large block of stock.[319] At the same time, the investment adviser entered into swap transactions with the banks from which it purchased the acquirer's shares, so that it "was able to acquire the voting rights to nearly ten percent of [the acquirer]'s stock without having any economic risk and no real economic stake in the company, [and] was able to do this without making a significant financial outlay."[320]

While the practice of empty voting was not asserted as a substantive violation in the enforcement action, the matter illustrates how hedging techniques can be used to obtain voting power without having economic exposure on the securities being voted. The use of hedging by insiders also can result in empty voting. Executives entering into "collars" transactions, for instance, retain full voting rights despite having hedged a portion of their economic interest.[321]

Empty voting can also be accomplished by the use of credit derivatives (rather than through the use of put options and other equity derivatives), a process dubbed "hybrid decoupling."[322] For example, instead of using put options to hedge its economic interest in shares, a shareholder may enter into credit default swap transactions with a derivatives dealer. If a company experiences poor economic performance, the likelihood of the company defaulting on its debt increases, and so the shareholder's credit default swap holdings will likely rise in value.[323]

Finally, hedging-based strategies need not even involve holding either the debt or equity of the company in which the shareholder is voting, or derivatives linked to such debt or equity. A shareholder may, for instance, be able to hedge its exposure to a company's shares through purchasing assets correlated in some fashion to the company's share price. In the case of an acquisition, for example, a shareholder in the potential acquirer which also holds a larger equity interest in the target company, may arguably be characterized as being an empty voter with a negative economic interest in the acquirer. That is, the more the acquirer overpays for the target, the more net profit the investor would achieve. Other correlated assets that may be used in empty voting strategies may include, for example, shares of a competitor or a supplier.

b. Empty Voting Using Non-Hedging Based Strategies

There are a variety of situations in which empty voting may arise without any hedging at all. For example, active trading between a voting record date and the actual voting date may result in many voters having voting rights different from their economic stakes. An investor who sells shares after the voting record date retains the right to vote the shares without having any economic interest in them. Another example of empty voting without hedging is the voting of employees' unallocated shares in an employee stock ownership plan ("ESOP"). In an ESOP, while employees only have a contingent economic interest in the unallocated shares, the shares have full voting rights and are voted by a trustee, who either exercises discretion in voting or votes in proportion to vested ESOP shares. Effectively, either the trustee or the employees may become empty voters.[324]

One important non-hedging based technique that appears to have been used outside the United States is borrowing shares in the stock lending market. Under standard stock lending arrangements, the borrower of the shares has the voting rights associated with the shares borrowed, but relatively little or no economic interest in the shares.[325] Thus, simply by paying a fee to borrow the shares, the borrower can "buy" votes associated with the shares without having any corresponding economic interest. And the size of the fee could be reduced by borrowing the shares immediately before the record date, and returning the shares immediately afterwards.[326] Within the U.S. this sort of practice appears to be limited by Regulation T, under which securities loans by institutional investors through their broker-dealers are restricted to distinct "permitted purposes" under the Federal Reserve Board's Regulation T, such as execution of a short sale.[327]

[317] For example, Delaware has amended its General Corporation Law to allow corporations to adopt measures to respond to certain record date capture strategies. *See* Bryn Vaaler, United States: DGCL Amendments Authorize Proxy Access And Expense Reimbursement Bylaws, Reverse Schoon v. Troy Corp., Mondaq Business Briefing, May 12, 2009, *available at http://www.mondaq.com/unitedstates/article.asp?articleid=79322.* Some corporations have adopted bylaws that, under certain circumstances, require shareholders submitting a proposal to disclose how they have hedged the economic interests associated with their share positions. *See* Matt Andrejczak, "Sara Lee, Coach set rules to deter devious shareholders," MarketWatch, Apr. 2, 2008.

[318] *See* In the Matter of Perry Corp., Release No. 34–60351, July 21, 2009 at ¶19, *available at http://www.sec.gov/litigation/admin/2009/34–60351.pdf.*

[319] *Id.* at ¶33.

[320] *Id.* at ¶18.

[321] In a "collar" transaction, the investor sells a call option at one strike price and purchases a put option at a lower strike price. For little or no cost, the investor thereby limits the potential for appreciation or depreciation to the range—the "collar"—defined by the two strike prices. Academic research indicates that CEOs, directors, and senior executives have used this strategy to hedge their economic interest in the firm's stock. *See* Carr Bettis, John Bizjak, and Michael Lemmon, *Managerial Ownership, Incentive Contracting, and the Use of Zero-Cost Collars and Equity Swaps by Corporate Insiders,* Journal of Financial and Quantitative Analysis, 2001, at 3.

[322] *See Hu & Black, Debt and Hybrid Decoupling,* note 309, above, at 688–690.

[323] And just as "equity decoupling" and "hybrid decoupling" could sometimes incentivize some shareholders to use their voting rights against the best interests of the company and other shareholders, some believe that a pattern that has been termed "debt decoupling"—the unbundling of the economic rights, contractual control rights, and other rights normally associated with debt—may sometimes raise incentive issues as to some debtholders. These debtholders, dubbed "empty creditors," may sometimes even have the incentive to use the control rights the debtholders have in their loan agreements or bond indentures to try to cause a company to go into bankruptcy. *See* Hu & Black, *Debt and Hybrid Decoupling,* note 309 above, at 665–66 and 679–688; "CDSs and bankruptcy—No empty threat," The Economist, June 18, 2009.

[324] *See* Hu & Black, *Empty Voting II,* note 309 above, at 648–651 (as to restricted stock voting rights and certain ESOPs).

[325] *See, e.g.,* Master Securities Lending Agreement at 7.1–7.5, note 72, above.

[326] Some observers believe that this stock lending-based strategy has occurred in Hong Kong and the United Kingdom. *See* Kara Scannell, "Outside Influence: How Borrowed Shares Swing Company Votes—SEC and Others Fear Hedge-Fund Strategy May Subvert Elections," Wall Street Journal, Jan. 26, 2007, at page A1.

[327] *See* Federal Reserve Board Regulation T, 12 CFR § 220.2. This regulation limits the purposes for which broker-dealers who do not transact with customers from the general public may lend shares. Regulation T's "purpose test" generally provides that borrowers may only borrow securities for short selling, covering delivery fails, and similar purposes. For a fuller description of Regulation T, see Charles E. Dropkin, "Developing Effective

Borrowing securities to obtain the right to vote, however, may occur outside the purview of Regulation T in certain circumstances.

3. Potential Regulatory Responses

As one possible response to empty voting and related phenomena, the Commission could consider requiring disclosure that creates transparency.[328] The proxy rules, the periodic reporting system, and rules adopted pursuant to statutory provisions such as Sections 13(d), 13(f), and 13(g) of the Exchange Act might be modified or a new disclosure system could be developed to elicit fuller disclosure of empty voting. More robust disclosure may be helpful to all of the participants in the proxy process as well as for regulators. For instance, if an investor acquires substantial voting rights that are not disclosed, then the other shareholders may not be aware of the potentially heightened importance of their vote. Without such information, shareholders may have insufficient information as to the need to vote and to take coordinated or other actions to protect their interests. By improving transparency, investors would have the option to choose to respond to such information and make a better informed investment or voting decision. Issuers also may be in a position to take responsible and appropriate action in response to disclosure of empty voting strategies, such as increasing their solicitation efforts.

Beyond gathering information and enhancing transparency, the following are some of the possible responses to empty voting and other types of decoupling that could be considered by the Commission, Congress, state legislatures, and individual issuers.

- Require voters to certify on the form of proxy or VIF that they held the full economic interest in the shares being voted at the time the proxy was executed, or, if not, disclose the extent to which their economic interest in the shares was shorted or hedged.
- Require disclosure of the shareholder meeting agenda sufficiently ahead of the record date to enable investors who have loaned their securities to recall those loans to retain voting control of those securities.[329]
- Permit only persons who possess pure long positions (*i.e.,* economic interests not shorted or hedged) in the underlying shares to vote by proxy, or allow proxy voting only commensurate with their net long positions (*e.g.,* economic interests after adjusting for equity or credit derivative-based hedging or short positions), or require a cooling-off period for those who have no or negative economic interests (after public disclosure) before voting.
- Prohibit empty voting, especially in situations where there is a negative economic interest.

4. Request for Comment

- What is the potential for, and actual prevalence of, all forms of equity, debt, and hybrid decoupling (including empty voting)? Are these techniques employed differently by "outside" investors, company insiders, and the company itself? Does decoupling raise public policy concerns, for example in relation to the disclosure requirements of Section 13(d)? Are existing disclosure requirements under Section 13(d) and other provisions of federal securities laws sufficient to address the entire range of concerns raised by equity, debt, and hybrid decoupling?
- Can the potentially beneficial and potentially detrimental aspects of debt, equity, or hybrid decoupling be meaningfully distinguished? Are there adverse consequences if there are empty voters, or even empty voters with negative economic interests, especially if their votes are outcome determinative? Are there examples of situations in which empty voting was outcome determinative?
- What are the mechanisms that result in debt, equity, and hybrid decoupling giving rise to public policy concerns? How important are these different mechanisms? To what extent can credit derivatives, correlated assets (such as, for example, shares of other participants in a takeover battle), or other financial instruments be used, and to what extent are they being used, to accomplish empty voting? To what extent does debt decoupling raise issues similar to those raised by equity decoupling or hybrid decoupling and how might regulatory or other responses to debt decoupling differ?
- At what economic threshold or percentage of voting power threshold is decoupling—by any one individual, by group, or by shareholders in the aggregate—material to the company and its security holders?
- Are certain companies (for instance, due to their ownership or capital structure) particularly vulnerable to potential adverse effects of debt, equity, or hybrid decoupling?
- Do concerns about decoupling economic interests and voting rights extend to the decoupling of voting and investment management functions within institutional investors?[330] If so, would one or more regulatory responses, involving disclosure or otherwise, be appropriate?
- Under what circumstances should disclosure of a shareholder's net economic interest be required, along with any associated decoupling? If such net economic interest is required to be disclosed, how should "net economic interest" be defined, given the myriad ways in which such decoupling can occur? Should our rules require disclosure regarding, and/or certification of, beneficial and economic ownership as part of the form of proxy or VIF? Or should this matter be left to state law or bylaws adopted by individual companies?
- If companies and company executives themselves engage in decoupling, do existing disclosure requirements result in sufficient transparency for investors to observe this behavior? If not, what level of disclosure would provide sufficient transparency? What changes to Schedules 13D or 13G, periodic disclosure requirements, Securities Act disclosure rules, the proxy rules, or other aspects of securities law are advisable?
- Are there circumstances (such as empty voting while holding a negative economic interest) where debt, equity, and hybrid decoupling appear to be fundamentally detrimental to the shareholders, debtholders, or the issuer itself? Are existing disclosure requirements, or changes to existing disclosure requirements, sufficient to address any such concerns? Should the Commission consider additional remedial actions? What role should federal law, state law and individual corporate actions play in addressing any such concerns?
- Should we propose rule changes to provide more disclosure and transparency as to equity, debt, or

Guidelines for Managing Legal Risks-U.S. Guidelines," Securities Lending and Repurchase Agreements 167, 172–176 (Frank J. Fabozzi and Steven V. Mann, eds., 2005). Essentially, Regulation T requires broker-dealers to make a good faith effort to ascertain the borrower's purpose and cannot lend shares for voting purposes because that is not a permitted purpose under Regulation T. 17 CFR 220.10(a). The standard securities lending agreement in the U.S. generally will contain a representation and warranty that the borrower, and any person to whom the borrower relends the borrowed securities, are only borrowing consistent with the "purpose test" (unless the borrowed securities are "exempted securities"). *See, e.g.,* Master Securities Lending Agreement, note 72, above, at 9.5 (at *www.sifma.org/services/stdforms/pdf/master_sec_loan.pdf*).

[328] The staff is also working on the separate but related project of reviewing current disclosure requirements relating to holdings of financial instruments, including short sale positions and derivatives positions.

[329] *See* Section III.C.2, above.

[330] *See* Nathan & Mehta, note 310, above.

hybrid decoupling? If so, should this disclosure be in proxy solicitation materials, periodic reports, or disclosures pursuant to Sections 13(d), 13(g), and/or 13(f)? Should we develop a specific new form or report relating to short sales, short sale positions, and debt, equity, or other derivatives that could be used to identify instances of potential or actual empty voting or other kinds of equity, debt, or hybrid decoupling? Should any requirements related to decoupling disclosure also require disclosure of credit derivatives positions, as would occur with hybrid decoupling? Should debt decoupling be subject to disclosure requirements and, if so, what disclosure requirements would be appropriate? To what extent would new legislation be necessary in order to impose any of these requirements?

- If we were to propose any enhanced or new disclosure requirements, what should the filing deadlines be under various circumstances in order to inform the marketplace on a timely basis, while providing adequate time for those responsible for complying with the requirement to collect the information and prepare the filing?
- What should be the triggers for such disclosure requirements? For instance, in establishing such a trigger, is the more than 5% equity ownership threshold of Exchange Act Section 13(d) analogous in any way? Are the current "beneficial owner" concepts contemplated by Regulation 13D–G, some variation of such concepts, or some altogether different concept of ownership appropriate for determining whether a disclosure requirement is triggered? Or should decoupling-related disclosures not be based on conceptions of ownership, but instead be based on the nature of the investor and presence of investment discretion, as with Form 13F? Are there alternatives to "ownership," the nature of the investor, and presence of investment discretion that should be considered?
- What level of detail should be required for decoupling-related disclosures, recognizing the complexity of, for example, many OTC derivatives?
- If, pursuant to state law or a company's articles or bylaws, there are substantive limitations on empty voting or other forms of decoupling, should the Commission accommodate the implementation of such limitations by, for instance, requiring disclosure or ownership certifications on the form of proxy or VIF?
- To what extent is Regulation T, by its terms, effective in limiting the borrowing of shares for voting purposes? Should the Commission or another regulator propose a new rule that would prohibit or restrict borrowing securities for purposes of obtaining the right to vote those securities?

VI. Conclusion

The U.S. proxy system is the fundamental infrastructure of shareholder suffrage since the corporate proxy is the principal means by which shareholders exercise their voting rights. The development of issuer, securities intermediary, and shareholder practices over the years, spurred in part by technological advances, has made the system complex and, as a result, less transparent to shareholders and to issuers. It is our intention that this system operate with the reliability, accuracy, transparency, and integrity that shareholders and issuers should rightfully expect.

We are interested in the public's opinions regarding the matters discussed in this concept release. We encourage all interested parties to submit comment on these topics. In addition, we solicit comment on any other aspect of the mechanics of proxy distribution and collection that commentators believe may be improved upon.

Dated: July 14, 2010.

By the Commission.

Elizabeth M. Murphy,

Secretary.

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