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## COALITION VIEWS ON SHAREHOLDER COMMUNICATIONS

The time has come for the U.S. Securities and Exchange Commission (“SEC”) to conduct a comprehensive evaluation of the existing shareholder communications system, which is cumbersome, circuitous, and overly expensive. New regulatory requirements and increasing shareholder activism have elevated the need for public companies to communicate more effectively with their shareholders. Moreover, advances in technology not only provide the opportunity for enhanced communication and efficiency in the proxy process, but also facilitate the decoupling of shareholder voting rights from shareholder economic interests. These developments must be addressed to protect the integrity of our corporate governance system.

### The “Street Name” System

More than 75 percent of all public companies’ shares are held in “street name,” meaning that the actual shareholders are primarily brokers, banks, and other financial institutions. These third-party intermediaries hold a company’s shares on behalf of their clients, the individual beneficial owners. Under state corporation laws, only the shareholder of record is provided the right to vote, as the “legal” owner of the shares. The voting rights of these third-party record holders are not passed on via proxy to their customers; instead, these financial intermediaries retain the right to vote the shares. Under SEC and stock exchange rules, brokers and banks or their agents deliver proxy materials to beneficial owners and request voting instructions. If voting instructions are not returned, brokers may vote on “routine” matters, where instructions have not been received 10 days before the meeting.

The “street name” system of share ownership was developed to enable securities transactions to be processed and cleared more efficiently. However, the shareholder voting process has been permitted to evolve in piecemeal fashion over many years. The current system is a complicated and multi-layered process routed primarily through financial intermediaries that are not the economic owners of corporate shares. The involvement of these third-party intermediaries increases the complexity and cost of processing proxy materials and tabulating votes. It also makes it more difficult for companies to communicate with the beneficial owners of their shares.

### The Barriers between Public Companies and Their Beneficial Owners

As noted above, a resulting complication of street name registration is that public companies do not know the retail investors who are the beneficial owners of their shares.

Under rules adopted in the mid-1980's, brokers and banks are permitted to classify beneficial owners as either Non-Objecting Beneficial Owners ("NOBOs") or Objecting Beneficial Owners ("OBOs"), based on indications by the beneficial owners at that time or account opening. Public companies are not able to communicate directly with their OBO beneficial owners and communication with even NOBOs is expensive and not permitted with respect to proxy materials. Thus, the proxy process is oriented more to the efficiency interests of brokers and banks than to encouraging effective and efficient communication between companies and their shareholders.

### The Lack of Competition in Proxy Processing Services

The overwhelming majority of brokers and banks have contracted out the processes of distributing proxy materials and tabulating votes to one company, Broadridge Financial Solutions. Brokers and banks accomplish this by transferring their proxy voting authority to Broadridge, which then mails proxy statements and voting instruction forms to beneficial owners. Broadridge does not transmit actual "proxies" to beneficial owners; instead it requests voting instructions from beneficial owners, while retaining the legal right to vote the shares. Pursuant to SEC and New York Stock Exchange ("NYSE") rules, companies are required to pay for the "reasonable expenses" of transmitting proxy materials at rates set by the NYSE. In other words, companies are required to pay for this service, even though they have no choice as to the service provider, nor any ability to negotiate fees with the service provider.

### Share Lending Practices, Decoupling of Ownership and Proxy Voting Integrity

The problems with the current proxy voting system are exacerbated by share lending practices that may cause an "over vote," *i.e.*, the receipt of more voting instructions than are in a financial institution's position, or other reconciliation problems in counting shares. Brokers and other financial institutions use different methodologies to address share reconciliation and tabulation issues. The result is that some shares may be voted multiple times and others not at all. What shares are counted and how they are counted need to be based on a uniform methodology that ensures accuracy, fairness, and democratic principles. Share lending agreements also generally assign voting rights to the borrower of the shares, causing a circumstance in which the person voting the shares may have little or no economic interest in the company. This so-called "empty voting" problem, in which investors have greater voting than economic ownership, arises from the ability of investors to use swaps and other equity derivatives to decouple voting rights from economic interests. And, under current SEC disclosure rules, investors often are able to avoid public disclosure of their enhanced voting power.

### The Role of Proxy Advisory Services

A final problem with the shareholder communications system involves the role of proxy advisory services. These advisory services are able to wield enormous influence in corporate elections, but they are not subject to any disclosures or oversight with respect to their ability to control the outcome of a vote. Some advisory services also have an

inherent conflict of interest in the voting process because they also provide related consulting services, such as corporate governance ratings, corporate governance advice, and other research services, in addition to providing voting recommendations on shareholder proposals submitted by their clients.

### Recommendations for Reform

Communications between companies and their shareholders are an essential component of corporate governance. With increasing shareholder activism and focus on the proxy voting process, public companies need to be able to quickly, efficiently, and cost-effectively communicate with all of their shareholders, including beneficial owners of their securities held in “street” or nominee name. In addition, enhanced disclosure of ownership interests is necessary to address the decoupling of voting and economic interests.

The proxy voting process in use today was created prior to recent advances in computer technology, including the modernization of the stock transfer system and the creation of the Internet. A reformed shareholder communications system should make use of these advances to facilitate more efficient communications between companies and their beneficial owners.

For all the reasons noted above, the SEC should initiate a comprehensive evaluation of the shareholder communications process. This evaluation should include the following principles and recommendations:

1. Direct Communications with Individual Investors. The SEC should eliminate the NOBO/OBO distinction thereby giving companies access to contact information for all of their beneficial owners and permit companies to communicate with them directly.<sup>1</sup> Shareholders desiring to remain anonymous should bear the cost of maintaining their privacy, such as through the establishment of nominee accounts.

2. Voting By Retail Investors. The SEC should examine how to protect the vote of the retail investor, particularly in the case of unvoted shares. Institutional investors generally vote 100% of the time, in response to their legal responsibilities and facilitated by electronic systems. They also are aided, as noted above, by proxy advisory services. Retail investors have no similar voting facilitators or proxy advisory services, and, in fact, often have no motivation to vote their shares. Among the alternatives that the SEC should consider to protect the interests of retail investors are: (a) pass through of voting rights directly to beneficial owners; (b) proportional voting; and (c) client directed voting.

3. Competition among Proxy Service Providers. Brokers, banks, and other intermediaries should not stand in the way of direct communications between companies and the beneficial owners of their securities. Companies should have the ability to determine the distributors of their communications, and should not be forced to pay for

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<sup>1</sup> Any improvements to companies’ ability to identify and communicate with their shareholders should also be available to shareholders wishing to communicate with other shareholders.

the costs of a system in which the fees and the service providers are determined by third parties.

4. Proxy Voting Integrity. The SEC should consider additional steps to ensure that the proxy voting system is transparent and verifiable. In this regard, the SEC should examine its ownership disclosure requirements and consider requiring disclosure of both voting and economic ownership along with both positive and negative economic ownership.

5. Proxy Advisory Services. The SEC should review the role of proxy advisory services and the procedures used by these firms in generating recommendations.