

MEMO# 21673

September 27, 2007

NYSE Proxy Working Group Report Addendum

[21673]

September 27, 2007

TO: BOARD OF GOVERNORS No. 23-07CLOSED-END INVESTMENT COMPANY MEMBERS No. 59-07SEC RULES MEMBERS No. 129-07SMALL FUNDS MEMBERS No. 91-07 RE: NYSE PROXY WORKING GROUP REPORT ADDENDUM

The New York Stock Exchange created a working group (“Working Group”) in 2005 to review NYSE rules governing the proxy voting process. The Working Group focused on NYSE Rule 452, which governs the circumstances under which a broker may vote on certain “routine” proposals if the beneficial owner of the stock has not provided specific voting instructions. The Working Group issued a report recommending, among other things, that discretionary broker voting be eliminated for the election of directors, including investment company directors (“Report”). [\[1\]](#) The Working Group has issued an addendum to the Report (“Addendum”).[\[2\]](#) Significantly, the Addendum contains the Working Group’s recommendation that the SEC retain discretionary broker voting for registered investment companies.[\[3\]](#) This and other aspects of the Addendum are summarized below.

Exemption for Registered Investment Companies

The Working Group recommended permitting brokers to continue to vote on any election of investment company directors on a discretionary basis if no instructions are received from beneficial shareholders. The Addendum states that the Working Group reviewed materials submitted by the Institute and other representatives of investment companies concerning the difficulties funds would have if discretionary broker voting were eliminated for director elections. The Working Group attached particular significance to the Institute’s research

report delineating the increased costs and burdens that would be experienced by funds as a result of the proposal.^[4] The Working Group also considered that investment companies are subject to distinct regulation under the Investment Company Act of 1940, while operating companies are not subject to the Investment Company Act. The Addendum states that the Working Group ultimately concluded that:

the unique regulatory regime governing investment companies made such companies sufficiently different from operating companies (regardless of size) that it was appropriate to treat such companies differently. Accordingly, the Working Group determined to amend its initial recommendation to the NYSE with respect to Rule 452 to make this recommendation apply only to operating companies, and to unanimously recommend that such changes to Rule 452 not apply to any company subject to the Investment Company Act of 1940.

Proportional Voting

The Addendum states that the Working Group previously reviewed proportional voting as an alternative to existing Rule 452.^[5] At the time of the Report, the Working Group recognized a number of potential benefits of, and possible issues with, a proportional voting system. In particular, it noted that a proportional voting system could allow uninstructed shares to be voted on every proposal in a manner that did not give any inherent advantage to either an incumbent board or a dissident shareholder. Despite this benefit, the Working Group recognized potentially difficult logistical details involved in any type of proportional voting system and that broker-by-broker proportional voting results could be subject to manipulation in some circumstances.

The Addendum notes that following publication of the Report, the Securities Industry and Financial Markets Association (“SIFMA”) issued a best practices memorandum. The memorandum recommended that its members review the current practice of automatically voting uninstructed shares in favor of management and to consider instead voting uninstructed retail shares in proportion to instructed retail shares. According to the Addendum, some brokers may begin this practice of proportional voting in the 2007 proxy season.

The Working Group determined that by limiting proportional voting to the retail vote, the potential for manipulation could be significantly reduced. Accordingly, it advised SIFMA that it did not object to brokers implementing proportional voting for retail shares. The Addendum notes that the Working Group plans to review brokers’ experience and consider whether proportional voting is viable.

Client Directed Voting

The Working Group also considered the advantages and disadvantages of client directed voting (“CDV”).^[6] According to the Addendum, some Working Group members were concerned that CDV could make it easy for investors, particularly retail investors, to make important voting decisions in advance without full information about the matters to be voted on. In contrast, others in the Working Group believed that CDV would make it easier for investors to vote, thereby making it easier for them to be engaged in the proxy voting process. The Working Group also discussed that under existing Rule 452, brokers may only vote on routine matters, while under CDV the routine/non-routine distinction would be eliminated. Further, they discussed that CDV would eliminate the need for Rule 452 in its entirety without causing difficulty for issuers to achieve quorum. The Addendum notes that some brokers have begun to consider possibly implementing CDV, and the Working Group continues to evaluate the advantages and disadvantages of such a system.

Working Group Subcommittees

After issuing its Report in 2006, the Working Group established the following three subcommittees: (i) the Communication and Proxy Process Subcommittee; (ii) the Investor Education Subcommittee; and (iii) the Cost and Pricing Subcommittee. The Addendum summarizes the work of each subcommittee.

According to the Addendum, the Communication and Proxy Process Sub-Committee discussed the feasibility of giving both issuers and dissident shareholders greater flexibility to choose among competing providers of shareholder communication services, while retaining the current system’s protections for proprietary broker data, shareholder privacy, and integrity of the vote tabulation process. Without further discussion, the Addendum notes that this subcommittee presented its findings to the Working Group.

The Education Subcommittee focused on how best to educate retail investors on the proxy voting process. In particular, they considered possible uniform guidelines that all brokers would use when opening brokerage accounts to clearly identify the differences between objecting beneficial owner status (“OBOs”) and non-objecting beneficial owner status (“NOBOs”).^[7] They also considered the possible need to ask existing beneficial owners with brokerage accounts to re-affirm their OBO/NOBO status based on guidelines developed by this subcommittee.

The Cost and Pricing Subcommittee discussed Rule 465 (the rule governing fees paid by listed companies to brokers for the distribution of proxy materials) and the NYSE’s role in establishing fees for the distribution of proxy materials. This subcommittee considered the likely costs of implementing a system of delivering proxy materials over the Internet, including the difficulties in determining such costs. The Working Group voted to

recommend that the NYSE not amend or extend Rule 465 to cover any of the new possible fees or costs raised by the SEC's recent rule permitting (but not requiring) issuers to deliver proxy materials through the Internet. Several factors were considered in reaching this decision, including that because the system is optional and has not been implemented by many issuers, market forces initially should be allowed to determine the appropriate pricing structure for this system. According to the Addendum, the Cost and Pricing Subcommittee will continue to monitor the situation and report back to the Working Group on any material developments related to e-proxy fees.

Dorothy M. Donohue
Senior Associate Counsel

2

hr align="left" size="1" width="33%"

[1] See Institute Memorandum to SEC Rules Members No. 49-06, Closed-End Investment Company Members No. 22-06, and Small Funds Members No. 41-06 [20095], dated June 8, 2006.

[2] The Report and Addendum are available on the NYSE's website at http://www.nyse.com/audience/listed_companies.html.

[3] The NYSE filed an amendment with the Securities and Exchange Commission that would implement the Working Group's recommendation. See Memorandum to SEC Rules Members No. 14-07, Closed-End Investment Company Members No. 29-07, and Small Funds Members No. 54-07 [21185], dated May 29, 2007.

[4] See Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of

[5] Under a proportional voting system uninstructed shares would be voted in the same proportion as instructed shares.

[6] Under client directed voting, an investor's brokerage agreement would allow (but not require) the investor to provide a "good until cancelled" instruction on matters to be voted on at companies in which they own stock. These choices could include an instruction to the broker to: (i) vote in accordance with the board's recommendation, (ii) vote against the board's recommendation, (iii) abstain from voting, or (iv) vote proportionally with the broker's retail clients' instructed votes. The recommended default position for clients who fail to specify a choice in their brokerage agreements would be proportional voting.

[7] OBOs object to brokers sharing identifying information with companies in which they own stock while NOBOS do not object to sharing this information.