The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC Concept Release on Proxy System; August 11th Conference Call

[24444]

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TO: SEC RULES COMMITTEE No. 30-10
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 13-10
ETF ADVISORY COMMITTEE No. 32-10
SMALL FUNDS COMMITTEE No. 9-10
TRANSFER AGENT ADVISORY COMMITTEE No. 40-10
BROKER/DEALER ADVISORY COMMITTEE No. 29-10 RE: SEC CONCEPT RELEASE ON PROXY SYSTEM; AUGUST 11TH CONFERENCE CALL

The Securities and Exchange Commission has issued a concept release requesting comment on various aspects of the U.S. proxy system. [1] The Release describes a number of issues that are of potential interest to investment companies both as issuers of, and investors in, securities, which are summarized below.

Comments on the proposal are due to the Commission by October 20, 2010. We will be having a conference call on Wednesday August 11th from 2:00-4:00 ET to discuss the proposal and the ICI's comments. The dial-in number for the call is (800) 779-2595 and the pass code is 38671. Please email Ezella Wynn at ewynn@ici.org if you plan to participate on the call. If you are unable to participate on the call, please provide your comments to Dorothy Donohue at ddonohue@ici.org, Frances Stadler at frances@ici.org, or Tami Salmon at tamara@ici.org before the call.

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

The Release seeks to explore concerns that have been expressed about the accuracy, transparency, and efficiency of the proxy voting process and ways in which those concerns might be addressed. These include:

- Concerns related to the potential for "over-voting" or "under-voting" of shares. The

Release focuses on the potential for imbalances where the number of securities of a particular issuer held in a DTC participant's account is less than the number of securities that the DTC participant has credited in its own books and records to its customers' accounts. According to the Release, these situations principally arise in connection with securities lending and "fails to deliver" in the clearance and settlement system. When there is an imbalance, the broker-dealer must determine if and how it should allocate the votes it has among its customer and proprietary accounts and then reconcile the actual voting instructions it receives with the number of securities it is permitted to vote with the issuer. The Release notes that neither Commission nor self-regulatory organization ("SRO") rules mandate that reconciliation be performed or a particular reconciliation methodology. The Release then describes a number of allocation and reconciliation methods used by broker-dealers and states that customers of a broker-dealer may not be aware of its allocation and reconciliation methods.

    - Request for comment: The Release seeks comment on whether it would be helpful to investors if broker-dealers publicly disclosed the allocation and reconciliation method they use 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. The Release suggests that such disclosure could be in writing and provided to customers upon opening an account and annually thereafter, and made available to the general public on the broker-dealer's Web site. Alternatively, the Release asks whether it would be beneficial to investors if broker-dealers were required to use a particular reconciliation method. The Release asks a number of specific questions related to this matter (pp. 36-38).

- Concerns about the inability to confirm whether an investor's shares have been voted in accordance with the investor's instructions ("vote confirmation"). The Release states that the inability to confirm votes is caused, in part, because no one individual participant in the voting process possesses all of the information necessary to confirm whether a particular beneficial owner's vote has been timely received and accurately recorded and tabulated. Further, there are no requirements to compel these entities to share information to allow for vote confirmations. It also states the Commission's view that both record and beneficial owners should be able to confirm their votes, and issuers should be able to confirm that the votes that they receive from third parties on behalf of beneficial owners properly reflect the votes of those beneficial owners.
    - Request for comment: The Release suggests, as one possible solution, that all participants in the voting chain 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, the Release suggests that 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. The Release asks a number of questions about this approach and the general concerns over vote confirmation (pp. 41-43).
- Concerns over proxy voting by institutional securities lenders. The Release notes that, while issuers are required to provide information in the proxy statement about the

matters to be voted on, the proxy statement typically is not mailed out until after the record date. Therefore, those institutional lenders may not know what is on the meeting agenda in time to determine whether they want to get the loaned securities back before the record date. The Release then seeks to examine: (i) whether decisions to recall loaned securities in connection with shareholder votes might be more timely and better informed; and (ii) whether increased disclosure of the votes cast by institutional securities lenders might improve the transparency of the voting process.
    - Request for comment: The Release asks whether the Commission should 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. The Release asks a number of related questions, and also asks for data on the recall of loaned securities for the purposes of voting (pp. 46-47). In addition, the Release asks whether Form N-PX, the form used by management investment companies to disclose proxy votes, should be amended to require disclosure of the actual number of shares voted or the number of portfolio securities for which a fund did not vote proxies because the securities were on loan or for other reasons.
- Concerns over proxy solicitation fees. The Release notes that 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. The Release describes in detail the fee structure for proxy distribution set forth in NYSE Rule 465, and notes that the SRO rules do not set rates for reimbursement of expenses relating to the "notice and access" proxy solicitation model.
    - Request for comment: The Release poses a number of questions related to whether the current fee structure reflects reasonable rates of reimbursement for services rendered in various contexts and whether the Commission should take steps to deregulate or otherwise improve competitive market forces with respect to proxy solicitations. The Release also seeks comment on an alternative to the current model, which would create a central data aggregator with the right to collect beneficial owner information from securities intermediaries. The aggregator would be required to provide that information to any agent designated by the issuer and would be entitled to structured compensation for its services. The series of questions related to this topic appears on pp. 60-63.

2. Communications and Shareholder Participation

The Release examines 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, and seeks comment on ways to improve these areas. This part of the Release is divided into three topics:

- Issuer communications with shareholders. The Release addresses concerns that arise out of the practice of holding securities in street name – that is, interposing securities intermediaries between issuers and the beneficial owners of their securities – and concerns about the cost and efficiency of the current system of communications between issuers and investors. Much of the discussion relates to the current designations of "objecting" beneficial owners (OBOs), who object to having their

names and addresses provided to an issuer, and “non-objecting” beneficial owners (NOBOs), who do not object to providing this information to issuers. The Release notes that mutual funds and other large institutional shareholders typically choose OBO status. The Release describes several recommended changes to the OBO/NOBO system made by commentators over the years. The Release states that the Commission is considering whether regulatory action is needed to make it easier for issuers to communicate with their shareholders.
    - Request for comment: The Release seeks comment on whether the Commission should: (i) eliminate the OBO/NOBO distinction, thereby making all beneficial owner information available to the issuer; (ii) require broker-dealers to disclose the consequences of choosing OBO or NOBO status; or (iii) have OBO or NOBO status be the default choice on customer agreements when a brokerage account is opened. The Release also has a number of questions relating to possible improvements in the 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. A series of questions related to these issues appears on pp. 74-77.
- Means to facilitate retail investor participation. The Release expresses concern over the historically low retail investor participation rates in the proxy voting process, and offers five sets of potential regulatory responses. These include: (i) possible investor education efforts; (ii) enhancements to brokers’ internet platforms; (iii) allowing for advance voting instructions (or so-called client-directed voting); (iv) facilitating investor-to-investor communications; and (v) improving the use of the Internet for the distribution of proxy materials.
    - Request for comment: The Release asks twenty-seven questions on this topic, ranging from general questions about what additional steps could be taken to encourage retail investor participation in the proxy process to very specific questions, such as whether the Commission should permit companies using a “notice and access” model for distributing proxy materials to include the proxy card with the Notice of Internet Availability of Proxy Materials. These questions appear on pp. 90-96 of the Release.
- Data-tagging proxy-related materials. The Release notes that proxy statement and voting information is neither required nor permitted to be provided to the Commission in interactive data format and seeks comment on whether it would be beneficial to investors to permit or require issuers, including investment companies, to provide proxy statement and voting information in interactive data format in addition to the traditional format.
    - Request for comment: The Release asks a number of questions about the costs and benefits of data-tagging various elements of proxy materials and Form N-PX filings, which appear on pp. 101-104.

3. Relationship between Voting Power and Economic Interest

The final part of the Release explores the possibility of “misalignment of voting power” from economic interest, specifically with respect to three areas in which concerns have been expressed:

- Proxy advisory firms. The Release describes the increasingly important role of proxy

advisory firms and the variety of functions they perform to assist institutional investors in exercising their voting rights. The Release describes two main areas of concern: conflicts of interest (e.g., when proxy advisory firms provide both proxy voting recommendations to institutional shareholders and consulting services to corporations seeking assistance with proposals to be presented to shareholders) ; and the accuracy of, and transparency in, the formulation of voting recommendations.
    - Request for comment: The Release asks a wide array of questions in this section, designed to elicit comment on whether the Commission 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, as well as about the accuracy and transparency of the formulation of their voting. For example, comment is requested on whether proxy advisory firms should be required to file their voting recommendations with the Commission as soliciting material on a delayed basis to facilitate independent evaluation by market participants of the quality of those recommendations. The request for comment on these issues appear on pp. 122-126.
- Dual record dates. The Release describes the impediments in Commission rules to allowing issuers to use "dual record dates" – i.e., to set voting record dates that more closely match the date on which voting actually occurs. The Release explores whether the Commission should propose action to accommodate issuers that wish to use separate record dates where permitted by state law, and if so, what action it should take. The Release notes that there are competing considerations in this regard. 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. 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.
    - Request for comment: The Release seeks comment on whether and why issuers might wish to use dual record dates. It also outlines two general models that the SEC could use to facilitate dual record dates, one focusing principally on the notice record date and the other focusing principally on the voting record date, and seeks comment on the benefits of each approach. The requests for comment appear on pp. 133-137.
- The potential for "empty voting" and "decoupling" of economic and voting interests. This part of the Release explores hedging and other strategies that might allow the voting rights of equity securities to be held or controlled by persons without an equivalent economic interest in the company.
    - Request for comment: The Release outlines and seeks comment on a range of possible responses to empty voting and other types of decoupling that could be considered by the Commission, Congress, state legislatures, and individual issuers. For example, areas to be considered include: (i) whether the Commission should require fuller disclosure of empty voting; (ii) whether only persons with pure long positions in the underlying shares to vote by proxy should be permitted to vote; or (iii) whether empty voting should be prohibited. Requests for comment related to this aspect of the Release appear on pp. 146-150.

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endnotes

[1] SEC Release Nos. 34-62495; IA-3052; IC-29340 (July 14, 2010), 75 Fed. Reg. 42982 (July 22, 2010) (the “Release”). The Release can be found on the SEC’s website at http://www.sec.gov/rules/concept/2010/34-62495.pdf.