

SUMMARY:

The United States Securities and Exchange Commission is seeking public comment on the way the proxy system in the U.S. works. The first review of its kind in 30 years, it seeks to improve communications, transparency and accuracy while at the same time clarifying the relationship between economic power and voting interest. We have summarized the main issues the SEC seeks to address in its concept release, including the topics of Issuer Communication with Beneficial Owners of Securities, Facilitating Retail Investor Voting Participation, Data-Tagging Proxy-Related Materials, Over-Voting and Under-Voting of Shares, Vote Confirmation, Share Lending, Proxy Advisory Firms, Dual Record Dates, “Empty Voting” and Impact of Potential SEC Rulemaking.

GLASS LEWIS WORLD GOVERNANCE FOCUS

SPECIAL EDITION: SEC ISSUES CONCEPT RELEASE ON U.S. PROXY SYSTEM

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At a July 14 open meeting, the **SEC voted unanimously** to issue a **concept release** seeking public comment on the mechanics of the U.S. proxy system. The concept release is part of the Commission’s first comprehensive review of the proxy voting infrastructure – or “proxy plumbing” – in thirty years.

On rare occasions, the SEC **publishes concept releases** to solicit public comment on broad reform issues as an initial step toward proposing new SEC rules. Subsequently, the Commission will solicit comment on the proposed rules before adopting them as final.

The SEC’s proxy system concept release focuses on three issues:

- The accuracy, transparency and efficiency of the voting process;
- Communications and shareholder participation; and
- The relationship between voting power and economic interest.

The public comment period is open for 90 days after the concept release is published in the federal register (i.e., until October 20, 2010). Public comments can be submitted [here](#). The SEC has posted public comments on the concept release [here](#).

Below, we summarize some of the specific issues the concept release seeks to address.

ISSUER COMMUNICATION WITH BENEFICIAL OWNERS OF SECURITIES

Under current SEC rules, companies primarily communicate with beneficial owners through brokers or bank intermediaries. These intermediaries are prohibited from disclosing to a company the identity of beneficial owners who object to that disclosure (objecting beneficial owners, or “OBOs”), and companies are prohibited from

contacting OBOs directly; however, companies may directly contact shareholders who do not object (non-objecting beneficial owners, or “NOBOs”).

Various groups had advocated for the SEC to take action on this issue prior to the publication of the concept release. The **Shareholder Communications Coalition** has **advocated eliminating** the OBO/NOBO distinction. The coalition’s members include the Business Roundtable and the National Association of Corporate Directors. In March, the Altman Group, a proxy solicitation firm, **issued a position paper** recommending that the SEC create a new category of All Beneficial Owners (“ABOs”). The Altman Group’s proposal would allow companies to access a complete list of beneficial owners in order to directly communicate with ABOs regarding annual and special meetings and a limited number of other events.

In February, the Council of Institutional Investors (“CII”) issued **a white paper study on the OBO/NOBO distinction** and its implications for shareholder communications and voting. The CII study concluded: “On balance, we believe that the immediate interest of shareowners and companies in better communications would be better and more effectively served with an incremental approach that promotes less reliance on – or eliminates altogether – the OBO/NOBO distinction and otherwise increases the potential for direct communications.”

The SEC’s concept release seeks comments on whether to preserve, eliminate, limit or discourage the use of OBO status.

FACILITATING RETAIL INVESTOR VOTING PARTICIPATION

The concept release presents several potential regulatory actions to facilitate retail investor voting participation, including adopting rules to allow for client-directed voting. Such a mechanism would enable brokers and other intermediaries to solicit voting instructions from retail investors on particular topics before receiving proxy materials from companies. Notably, in February the SEC created a web site aimed at educating shareholders about the proxy voting process.

DATA-TAGGING PROXY-RELATED MATERIALS

As part of its previous efforts to increase transparency, the SEC had **adopted rules** requiring public companies to provide their financial statements in an interactive format using eXtensible Business Reporting Language (“XBRL”). The recent concept release considers whether the Commission should permit or require public companies to provide proxy statement and voting information in a similar data-tagging format. This proxy-related data may include information on executive compensation and director qualifications.

OVER-VOTING AND UNDER-VOTING OF SHARES

Broker-dealers and other intermediaries occasionally cast more votes – or fewer votes – than the number of shares that the intermediary actually holds. Broker-dealers have developed methods to reconcile voting differences and allocate votes to their customers in order to avoid “over-voting.” This process can result in “under-voting,” which occurs when investors who have the ability to vote fail to do so, or when investors are allocated fewer votes than the number of shares they own.

The concept release seeks comment on whether over-voting or under-voting is a problem, and whether the Commission should require broker-dealers to allocate votes based on a particular method.

VOTE CONFIRMATION

The concept release considers whether the SEC should require vote tabulators, securities intermediaries and proxy service providers to give investors and issuers access to vote records so that they can confirm votes have been received and tallied according to investor voting instructions. In order to protect the identity of OBOs from issuers, the SEC proposes to create an audit trail system that assigns beneficial owners a unique identifying code.

SHARE LENDING

When institutional investors lend their portfolio securities, the lender generally may not vote these shares unless they are recalled. The concept release asks whether the SEC should require issuers to publicly disclose meeting agendas in advance of record dates to allow securities lenders time to recall and vote their shares.

PROXY ADVISORY FIRMS

The concept release seeks public comment on how to address certain concerns regarding the role of proxy advisory firms. In particular, the concept release asks whether these firms should be required to specifically disclose potential conflicts of interest, and whether increased regulatory oversight is appropriate. The concept release also considers whether proxy advisory firms should be required to register with the SEC and file their voting recommendations with the SEC – at least on a delayed basis – to facilitate independent evaluation of those recommendations by market participants.

DUAL RECORD DATES

Recent changes to Delaware law and the Model Business Corporation Act allow for “dual record dates” – one for determining who is entitled to receive notice of the meeting and another for determining who can vote at the meeting. In light of these changes, the SEC is requesting public comment on whether its rules should be revised to accommodate dual record dates. The adoption of dual record dates is intended to ensure that shareholders without an economic stake in an issue are not able to influence the outcome of a vote.

“EMPTY VOTING”

The SEC’s concept release seeks input on whether certain techniques, such as “empty voting,” are being used to inappropriately influence corporate voting results. Empty voting occurs when a shareholder’s voting rights substantially exceed their economic interest in the company. In such instances, the voting rights are “decoupled” from the economic interest. The Commission offers potential regulatory actions to address this concern, including requiring full disclosure of empty voting or prohibiting the technique, especially in situations where there is a negative economic interest.

IMPACT OF POTENTIAL SEC RULEMAKING

The SEC’s concept release addresses key aspects of the U.S. proxy voting system and could result in new rules intended to promote greater efficiency and transparency, as well as ensure the accuracy and integrity of shareholder voting. These reforms would likely have a broad impact on all participants in the proxy voting process.

