

PUBLICATION

SEC Requests Comment on Proxy System

August 5, 2010

In its July 14, 2010 open meeting, the SEC issued a concept release (<http://www.sec.gov/rules/concept/2010/34-62495.pdf>) requesting public comment on a number of aspects related to the U.S. proxy system. The concept release seeks comment on issues related to the following three main areas: (1) the accuracy, transparency and efficiency of the proxy system; (2) communications with shareholders and shareholder participation; and (3) the relationship between voting power and economic interest. There is a 90-day comment period for the concept release. If you are interested in commenting, please review this alert and contact one of the attorneys listed below.

Accuracy, Transparency and Efficiency of the Proxy System

Over- and Under-Voting

The SEC is seeking comment on whether it is beneficial for investors to require each broker-dealer to disclose its particular method for allocating votes to its customers in over- or under-vote situations or whether broker-dealers should be required to use a particular allocation method. Because neither SEC nor SRO rules provide for a uniform method of allocating votes to customers in such situations, individual broker-dealers have developed different methodologies to address them.

Vote Confirmation

The SEC is seeking comment on whether it should require market participants to share vote information they possess in such a way as to allow investors and issuers to confirm that a particular vote is timely received and is reflected in the final vote tally on a matter. Currently, due to the complex web of market participants that may be involved in the proxy voting process, it is not possible for either an investor or an issuer to confirm that the investor's vote is accurately transmitted and tabulated.

Institutional Securities Lender Voting

The SEC is seeking comment on whether issuers should be required to publicly disclose a shareholder meeting agenda prior to the record date for the meeting to permit securities lenders to vote loaned securities. In order to vote loaned securities, the lender must terminate the loan and recall the loaned securities prior to the record date for a meeting. The SEC expresses concern in the concept release that institutional investors that lend securities may not receive sufficient advance notice of a matter to be voted upon to timely recall loaned securities in order to vote them. Also, while mutual funds are currently required to disclose how they vote proxies related to securities in their portfolios, the SEC is seeking comment on whether it should require mutual funds to provide additional disclosure related to the number of actual shares they vote at a particular meeting and the amount of portfolio securities not voted because they were on loan or for other reasons.

Fees for Distribution of Proxy Materials

The SEC is seeking comment on whether the current fee schedules for distribution of proxy materials should be revised, or in the alternative, eliminated entirely and replaced with a market-based system for fees. Under

the current proxy system, broker-dealers and banks are required by SEC rules to forward certain proxy materials to their customers and are entitled to the reimbursement of reasonable expenses incurred in distributing the materials based on SRO-adopted fee schedules.

Communications with Shareholders and Shareholder Participation

Issuers' Ability to Communicate

The SEC is seeking comment on whether the distinction between objecting beneficial owners and non-objecting beneficial owners should be eliminated. In the alternative, the SEC asks whether the standard should be refined such that non-objecting status is the default or that broker-dealers are required to disclose to investors the consequences of selecting one status over the other. Currently, an issuer may not contact directly beneficial owners of securities held in "street name" if the owners object to the disclosure of their names and addresses to the issuer. Because the great majority of securities are held by these "objecting beneficial owners," issuers have expressed concern about communicating directly to them in an efficient and cost-effective manner under current SEC rules.

The SEC is also seeking comment on whether the layout and format of proxy materials could be improved to facilitate greater participation by investors.

Retail Participation

Due to a decline in retail voting participation, the SEC questioned whether issuers are able to meaningfully engage retail investors in the proxy voting process, especially in light of the recent notice and access rules that permit internet delivery of proxy materials. The SEC noted its belief that this decline in retail participation could be stemmed by improved investor education, which may dispel some of the potential misunderstandings that retail investors have about the proxy voting system. In addition, the SEC is seeking comment on other suggested means to improve retail participation, including: (1) enhanced broker-dealer websites; (2) solicitation by securities intermediaries of advance voting instructions; (3) facilitating greater investor-to-investor communication; and (4) revisions to the notice and access model.

Data-Tagging

The SEC is seeking comment on whether it would benefit investors if issuers are permitted or required to provide proxy materials in interactive data format and the costs of providing such materials.

Relationship Between Voting Power and Economic Interest

Role of Proxy Advisory Firms

The SEC is seeking comment on whether it should regulate proxy advisory firms more closely, including possibly requiring more extensive disclosures of conflicts of interest and the methods firms use in arriving upon their recommendations, or requiring proxy advisory firms to register with the SEC under the Investment Advisers Act of 1940. Due to the increased reliance on proxy advisory firms by institutional investors, a number of concerns have been raised about the adequacy of conflict of interest disclosures made by the proxy advisory firms and the accuracy of and accountability for recommendations made by these firms.

Dual Record Dates for Shareholder Meetings

The SEC is seeking comment on whether it should revise the proxy rules to accommodate the use of dual record dates for shareholder meetings. Because issuers typically set a single record date for determining which shareholders are entitled to receive notice of a meeting and entitled to vote at the meeting, a mismatch in voting rights and economic interest may occur in that a person who no longer has an economic interest in the issuer may be able to vote a share that the person has transferred after the record date but prior to the meeting date.

"Empty Voting" and "Decoupling" Issues

The SEC is also seeking comment on whether and to what extent it should attempt to address concerns regarding "empty voting" and "decoupling" issues in which a security's economic interest and its voting right are split in some way. An example of this arises when an investor holds shares but hedges the underlying economic interest in those shares through the use of put options, leaving the voting rights with a shareholder who no longer has an economic interest in the issuer. The SEC is seeking input on whether it should require disclosure regarding such arrangements through revisions to the proxy rules or otherwise.

If you have questions about this or any other securities-related issue, please contact your Baker Donelson attorney.