

## CSCS 2011 Shareholder Democracy Summit

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The two biggest barriers to fixing the current proxy voting system is a lack of transparency and expense.

**Transparency** -The proxy system is complicated because there are multiple parties connected each with a responsibility to complete and deliver one aspect of the voting process. Each participant in the system to some extent is blind to the actions of the other part involved in the system. No one has a complete picture of the process and there are no checks and balances.

The Issuer is often blind to a large part of his shareholder base. They do not control the delivery or voting process so it is impossible for them to ensure that all shareholders with the right to vote receive a proxy. They are also blind to the majority of shareholders voting and therefore can't confirm that any vote cast has been received. As long as there is an OBO component to the shareholder base there will always be a portion of the shareholder base that the issuer is not aware of and therefore would not be able to ever be in a position to confirm receipt and acceptance of that shareholders vote. When an issuer receives the OBO vote and sometimes the NOBO vote, it is voted as one large vote under each custodian's name. They often are not aware of who those underlying shareholders are and do not have the ability to communicate with them directly.

The registered holder is CDS however the issuer is provided with a breakdown by CDS giving authority to the brokers to vote a certain amount of shares (omnibus proxy). However, Broadridge and the custodians are not provided a copy of that record date position so there is no reconciliation by either party with the number of shares mailed out by proxy to what they are actually entitled to vote. A broker is often unaware if they have made a mistake and not mailed a proxy to an eligible holder or as is more often the case, they have mailed out proxies to holders that are not eligible to vote. There is also no reconciliation process once a vote is cast with the scrutineer as to whether all the votes sent were received or counted. The brokerage house and Broadridge can confirm to an investor that their vote has been cast but can't give any reasonable assurance that their vote was received or counted by the scrutineer.

**Expense-** It is often commented that the beneficial shareholder system works for dividend payments and settlements so it should be able to work for proxy voting as well. However, this would involve expenditure to improve the system and there must be incentive for parties to make that investment. It is crucial to investors that the dividend and settlement system works each and every time so they receive the correct compensation for each payment. This has resulted in the investment community making the necessary investment with CDS to ensure an ordered and systematic flow of funds between the various investment communities. The issuer makes one payment to CDS and DTC and the money is distributed effectively to the various parties. There is a simple set of rules with ex dividend dates and settlement dates that dictates who is to receive which payment. The record date for these payments is strictly observed and positions are reconciled by the custodians. The investment community has made the initial investment in the system and subsequent investment in resource to make sure the flow of funds is efficient for each and every payment.

There is no similar system for proxy voting primarily because the incentive has not been there previously to make the investment in the system. It is slowly gathering more attention but historically there has not been a lot of interest in ensuring that shareholders votes have been received and adequately reflected by the scrutineer. It historically has only been when errors in tabulation have occurred on high profile or significant corporate that focus was brought to the process. As institutional investors are now becoming more interested in corporate governance and thus wanting to ensure that their votes are received and thus their views expressed that more attention has been brought to the process. Historically, holders who did not like the way a company was performing would sell their stock. Pressure for change in management was brought by a low stock price. Investors are now asking for and receiving increasing levels of disclosure and wanting their voice to be heard before it reflects in the stock price. As a result Issuers who have historically viewed their annual meeting as routine have also placed increased importance. The technology exists in order to have a more efficient flow of information between the various parties in the proxy voting system but there would need to be investments in systems and an emphasis given to ensuring the same accuracy in dividend and corporate actions payments is taken with the proxy system. There however needs to be an economic incentive for parties to make those investments in system and process.

## Improvements to the current voting system.

1. **Mail to all holders:** Currently holders when opening a brokerage account, have the option to receive all material, only when it is a special meeting, or decline all material. As a result an issuer has the option when mailing material to only mail to a portion of their shareholder base. In addition to mailing to only holders coded A, for an annual meeting, they do not need to pay for OBO mailings or provide material to the US for mailing. An issuer trying to control costs could opt to mail to only holders coded A, not pay for OBO mailing and not provide material for the US mailing. In essence a large part of their shareholder base would not receive a proxy and most likely will not vote. However for some issuers mailing to all holders can be a very prohibitive expense. An investor that doesn't receive a proxy is still entitled to vote but would need to make significant effort to have that ability to vote. They would also need the knowledge to obtain what is necessary to vote as well as a prompt to know the meeting is occurring.

In order to take into consider an issuers need to control expenses and an investors right to vote would be to introduce notice and access. This would allow issuers to reach all their holders and holders would be less likely to object to unwanted material if it was in electronic form. The notice and access system would need to be implemented in a manner that avoids a lot of the pitfalls of the US system. The costs involved in implementing notice and access has proved to be more prohibitive then the savings received by not mailing material. There has also been a drop in retail participation. A system that would encourage competition and issuers to choose their own notice and access provider could help control the costs. Also care will need to be taken that the process is not complicated and communicated clearly so retail investors are also encouraged to participate.

2. **Reconciliation required:** Brokers currently mail proxies to holders as a record date set for the meeting. However, there is no reconciliation between their CDS and DTC position and the number of shares they mail to their shareholders. In the US they are required to reconcile their positions and correct before mailing the material. This has greatly reduced the over voting in the US and given greater assurance that the holder entitled to vote receives their proxy. There could also be reconciliation between votes received by a scrutineer and votes submitted by various parties.

- 3. Similar treatment of shareholders.** The current voting rules treat shareholders' differently depending on whether they are registered, NOBO or OBO holders. Their ability to vote and how their votes are treated will vary given various scenarios and often the underlying shareholder is unaware of the difference in treatment. The elimination of the OBO component allows regulators to change the rules that allow all holders to be treated equally.

The different treatment is not only limited to the ability to vote at a shareholder meeting on various matters. An example of different treatment, a broker has mailed more shares than their CDS position allows. If Broadridge does the mailing then the shares will most likely be prorated and all holders will be treated the same. However, at the chairman's discretion, they could also be treated as first in first out or votes are only taken until the amount shares voted are exceeded. However, if the issuer or transfer agent does the NOBO mailing then those shares are taken from the custodian position and given to the NOBO holder. Even if the NOBO holder doesn't vote their shares, the brokerage position is reduced by that number of shares and the OBO component only is prorated.

Another example is registered holders are normally the only holders allowed to attend the meeting and vote in person without completing the proxy appointment process. However, in some instances at the chairman's discretion if the issuer or scrutineer does the mailing, NOBO holders may be allowed to attend and vote at the meeting. The only holders not entitled to vote at the meeting would be OBO holders.

There are numerous examples of different shareholder treatment depending on what choices issuer and shareholder make.

If the OBO component of a shareholder base was eliminated then issuers and investors would be able to communicate with each other more effectively and it would pave the way for equitable treatment of all holders.