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United States Proxy Exchange

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VIA UPLOAD: http://www.sec.gov/rules/proposed.shtml

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

File No. S7-14-10 - Concept Release on the US Proxy System

Dear Ms. Murphy:

The United States Proxy Exchange (USPX) is pleased to submit comments on the Concept Release on the US Proxy System: S7-14-10. We are a non-government organization, incorporated in the Commonwealth of Massachusetts, that is dedicated to facilitating shareowner rights, primarily through the proxy process.

Our responses to the specific questions posed by the Commission follow. We have numbered them according to the order they appeared in the Concept Release. Breaks in the ordering indicate questions we have chosen to not answer.

1. What are the advantages or disadvantages of the various methods of allocation or reconciliation currently used by securities intermediaries and the effectiveness of such methods?

A shortcoming of all the reconciliation methods described in the Concept Release is their focus on allocating votes to shareowners. They should focus instead on allocating vote deficiencies to shareowners—i.e. deciding which shareowners will receive less votes than the number of shares they hold. Vote deficiencies can arise for different reasons, and they should be allocated differently according to their cause. For example, a shareowner who has held shares for five years shouldn't lose the right to vote some of those shares because her securities intermediary did not receive delivery on some other clients' trades. Methods that focus on allocating available votes fail to make such distinctions. There should be one allocation method for vote deficiencies due deliver failures, another for those due to securities lending, and a third for those due to margining.

In an honest election, votes that aren't cast should remain not cast. You don't offer those votes up to whomever would like a little extra suffrage: "Unused votes! Who wants 'em?" That, essentially, is what the post-reconciliation and hybrid methods do, at least as described in the Concept Release. By "recycling" votes other shareowners have chosen not to cast, they boost certain sharowners' voting power beyond what it would be if individual shares were tracked through clearance and settlement to individual beneficial owners.

The post-reconciliation and hybrid methods (as described) also open the door to abuse by securities intermediaries who want to favor certain clients over others or want to influence a corporate election by facilitating voting by certain clients but not others. It is all nice and good to say that investors in a securities lending program can ask to be allocated votes, but how do we know a securities intermediary will keep all clients equally apprised of this "option"? Will certain clients receive timely reminders to submit such requests while others do not? This problem can be fixed by distributing vote deficiencies according to some specified pro rata formula.

2. Is there any evidence, statistical, anecdotal or otherwise, of material over-voting or under-voting, and if so, what is the size and impact of over-voting or under-voting? For example, is there any evidence that over-voting or under-voting has determined the outcome of a vote or materially changed the voting results?

The Commission's Concept Release never defines "over-voting", but it uses the term in the same way the securities industry does: over-voting is instances of a DTC participant submitting more votes than they have shares on deposit with DTC. In 2006, the NYSE took administrative action against four DTC participants—Deutsche Bank, UBS, Credit Suisse Securities and Goldman Sachs Execution & Clearing—for such over-voting. We believe the securities industry has taken steps to routinely check a DTC participant's holdings against the number of votes it submits.

"Over-voting" might be defined more broadly as instances of *any* securities intermediary submitting more votes than the number of security entitlements it holds. If a securities intermediary is not a DTC participant—and most are not—their holdings are not listed on the Cede breakdown. Alternative means of policing such over-voting would be required. We are not aware of any systematic effort by the securities industry to perform such policing.

3. Are there any concerns caused by over-voting or under-voting that are not described above? Are there particular concerns regarding the impact of either over-voting or under-voting with respect to specific types of voting decisions, such as merger transactions, the election of directors where a majority vote is required, or shareholder advisory votes regarding executive compensation? What, if any, alternatives should we consider to the current system, and what would be the costs and benefits of any alternative process?

Over-voting is a problem, but it also should be recognized as a symptom. Why does over-voting occur? According to the Concept Release, it occurs when securities intermediaries fail to withhold sufficient votes from clients who engage in securities lending or margining (and, to a lesser extent, those whose buy orders fail to deliver.) This explanation appears incomplete. Here is why.

If a securities intermediary uses a pre-reconciliation method for allocating votes, there should be no over-voting. The securities intermediary will allocate the votes at their disposal and no more. If the securities intermediary uses a post-reconciliation or hybrid methodology, it is theoretically possible their clients will cast more votes than the firm has at its disposal. But the Concept Release indicates that it is generally securities intermediaries who serve retail investors who tend to use post-reconciliation or hybrid methods. Since only 20% to 30% of retail investors typically vote their shares, it is difficult to imagine how such securities intermediaries could experience an insufficiency of votes that results in an over-vote situation.

The few available accounts of over-voting suggest that errors, lost votes, double- or triple-counted votes or perhaps intentional abuse contribute as much, if not more, to the problem of over-voting than the issues of securities lending, margining and failed trades mentioned in the Concept Release. In this light, over-voting may be viewed as a symptom of broader underlying problems. We understand the securities industry is taking steps to address the narrow problem of over-voting. That is good, but assurances that the problem has been addressed may come across as like a doctor assuring a patient her symptoms have been treated. Treating symptoms is nice, but what about the underlying problem?

We believe the Commission needs to conduct a thorough investigation of all possible causes of inaccuracy in corporate elections.

4. Would requiring broker-dealers to disclose their allocation and reconciliation process adequately address the concerns related to over-voting and under-voting by beneficial owners?

The Commission has proposed that securities intermediaries be allowed to continue using allocation methods of their choosing but require disclosure of the methodologies so shareowners can "decide if a particular broker-dealer's method suits their investment goals". We oppose this proposal for several reasons.

First, it ignores the fact that all shareowners will be impacted by a securities intermediary employing an allocation method that distorts election results. The Commission needs to specify one reconciliation method for all securities intermediaries that protects all shareowners' interests.

Second, few investors will comprehend such disclosures. Most have no comprehension of securities lending. They certainly won't understand the impact securities lending might have on their voting rights, assuming their securities intermediary adopts this or that reconciliation method.

Third, even if an investor does understand the disclosures, he is unlikely to switch securities intermediaries as a result. Data indicates it is hard enough to get shareowners to read their proxy materials and vote. They are not going to be switching securities intermediaries over arcane proxy voting issues.

Fourth, because securities intermediaries will face little or no risk of losing clients over their choice of reconciliation method, they will be free to chose whatever method is most expedient or least expensive for them.

Finally, in our answer to question 1, we indicated that certain reconciliation methods may facilitate manipulation or abuse. If brokers are allowed to chose whatever method they like, some are likely to select (or otherwise continue to use) such methods.

For these reasons, securities intermediaries should not be allowed to choose their own reconciliation methods. Disclosure is not a remedy.

5. Would information about vote allocation and reconciliation methods be helpful to investors or adequately address any concerns related to those processes?

The Commission has already provided such information and assurances in the Concept Release. We don't believe further information or assurances on this narrow topic would be helpful. Shareowners widely perceive that corporate elections are flawed and their results are inaccurate. That is the problem the Commission needs to address. Information or assurances about the narrow topic of reconciliation methods will not address it.

6. Would a particular type of vote allocation and reconciliation method better protect investors' interests?

The Commission's Concept Release indicates a commitment to the accuracy of corporate elections. But what is "accurate"? The Concept Release never says. It doesn't define what it means for a corporate election to be accurate.

Section III of the Concept Release—the one that deals with "accuracy"—focuses on the problem of over-voting. We hope the Commission does not deem a corporate election "accurate" if there is no over-voting. That would be like deeming a balance sheet "accurate" if assets equal liabilities. Just as a financial statement can be in balance and still contain mischief, a corporate election can have no over-voting and still be flawed.

We define a reconciliation method as "accurate" if it reproduces the result that would be obtained if, instead of the current system of street name registration, a direct registration system prevailed, with individual shares tracked through clearance and settlement to individual beneficial owners. With an accurate reconciliation method, as so defined, there will never be over-voting of any sort. Votes won't be recycled, as defined in our response to question 1. No investor will be denied a vote because someone else's trade failed to settle. Investors' interest in fair, undistorted corporate elections will be protected.

None of the reconciliation methods described in the Concept Release are accurate because they all focus on allocating votes to shareowners. They should focus instead on allocating vote deficiencies to shareowners—i.e. deciding which shareowners will receive less votes than the number of shares they hold. The two approaches are different, and here is why. Vote deficiencies can arise for different reasons, and they should be allocated differently according to their cause. Methods that focus on allocating available votes fail to do so.

A shareowner who has held shares for five years should not lose the right to vote because some other client's buy order failed to deliver. For this reason, there should be separate reconciliation methods for lent securities and failed to deliver securities. If vote deficiencies arise from other causes, there should be separate reconciliation methods for those too. If brokers complain that this is too burdensome, then they should not hold shares in bulk fungible form. Accurate corporate elections are more important than expedience.

Let's first address vote deficiencies arising from lent securities. For these, a pre-reconciliation method can be accurate. Vote deficiencies should only be allocated to shareowners with margined or lent securities. Requiring that a securities intermediary pre-identify which clients will be denied votes has much the same effect as requiring the securities intermediary to pre-identify which shares have been lent. It will satisfy our definition of "accuracy".

In an honest election, votes that aren't cast should remain not cast. You don't offer those votes up to whomever would like a little extra suffrage: "Unused votes here! Who would like 'em?" That, essentially, is what the post-reconciliation and hybrid methods do, at least as described in the Concept Release. By "recycling" votes other shareowners have chosen not to cast, they boost certain sharowners' voting power beyond what it would be if individual shares were tracked through clearance and settlement to individual beneficial owners.

The post-reconciliation and hybrid methods (as described) also open the door to abuse by securities intermediaries who want to favor certain clients over others or want to influence a corporate election by facilitating voting by certain clients but not others. It is all nice and good to say that investors in a securities lending program can ask to be allocated votes, but how do we know a securities intermediary will keep all clients equally apprised of this "option"? Will certain clients receive timely reminders to get such requests in while others do not?

A similar concern arises with the pre-reconciliation method if the securities intermediary is allowed to decide which securities lending or margin account clients to deny votes. Even if the decision is "random", there could be abuse. After all, how do you audit a "random" decision? We believe the Commission should mandate a pre-reconciliation method for allocating vote deficiencies arising from lent securities, but the vote deficiencies should be allocated pro rata among clients who lend or margin securities according to an explicit formula, which the Commission should specify.

Turning now to vote deficiencies due to delivery failures. For reasons similar to those above, we believe the Commission should mandate a pre-reconciliation method for allocating vote deficiencies arising from delivery failures, but the vote deficiencies should be allocated pro rata among clients with buy orders that were scheduled to settle on the date of the delivery failure. Again, the Commission should specify an explicit formula.

7. Do the varying methods of vote allocation affect the potential to audit votes cast by beneficial holders?

If a reconciliation method employs a lottery for allocating vote deficiencies, that will be impossible to audit. Lotteries can be manipulated, so how do you go back and determine if a lottery allocation was truly random? For that reason, we recommend pro rata approaches to allocation.

To facilitate audits, it is essential that the Commission mandate one uniform reconciliation method for all securities intermediaries. The Commission can specify what data securities intermediaries must retain to facilitate audits. Allowing every securities intermediary to concoct their own proprietary reconciliation method would be like allowing every corporation to concoct their own proprietary accounting method. The cost of a single audit could be prohibitive.

8. Should investors who have fully paid for their securities be allocated voting rights over those who purchased the securities on margin? Should beneficial holders be allocated voting rights over broker-dealer proprietary accounts?

If a vote deficiency arises due to margin accounts, it should be allocated solely to shareowners who have margined securities. There is no reason why votes should be transferred from a securities intermediary's account—voluntarily or otherwise—to cover vote deficiencies arising from clients' securities lending, margining or delivery failures. Accurate, honest corporate elections require that all shareowners be treated equally, and that shareowners whose actions result in vote deficiencies should be allocated those vote deficiencies.

10. Does the current system of settlement and clearance of securities transactions in the U.S. create any problems or inefficiencies in the proxy process in regard to matters other than over-voting or under-voting? If so, what are they, and what steps should we consider in order to address them?

The purported issuance of security entitlements by DTC to satisfy delivery failures—especially in instances of naked short selling—needs to be properly accounted for when proxies are distributed.

Shareowners have a right to withhold their proxies, but broker voting under NYSE Rule 452 denies them this right. In any voluntary deliberative body, participants have the right to actively not participate. The primary reason for doing so would be instances when the rules of order are inherently unfair. This problem can arise with annual meetings, where management has full discretion over the rules of order. This has been an issue with recent attempts by corporations to impose "virtual-only" annual meetings on shareowners. Without other means of recourse, shareowners may, in some instances, need to withhold their proxies. The Commission should enforce this right by allowing shareowners to prevent anyone from voting a proxy on their behalf. One solution would be to do away with Rule 452 entirely. Another would be to provide a check box on all proxies or VIFs allowing shareowners to withhold their proxy.

11. To what extent have shareholders had difficulty in confirming whether their submitted votes have been tabulated? To what extent have issuers had difficulty in determining whether the votes submitted by securities intermediaries/proxy advisory firms/proxy service providers accurately reflect the voting instructions submitted by beneficial owners?

To our knowledge, there is no independent tracking system to confirm that submitted votes were tabulated or that tabulated votes accurately reflect what was submitted. Vote tabulators receive anonymized votes that supposedly originated with shareowners whose identities are withheld from issuers. They have no means of checking if votes are valid or if some votes got misplaced along the way.

We understand Broadridge offers large institutional shareowners a service whereby they confirm with a vote tabulator whether that shareowners' votes were correctly tabulated. Since there is no third party providing this confirmation, we do not consider the service reliable. It is not available to retail investors.

12. To what extent do investors believe that their votes have not been accurately transmitted or tabulated, and what is the basis for such belief? Is there sufficient information about the ways that investors actually place their votes, for example, by telephone, on paper, or via the Internet? Do investors have concerns about whether the method they use to place their votes affects the likelihood that their vote will be accurately recorded?

Corporate elections are widely perceived as inaccurate. A lack of transparency is one reason. Broadridge Financial Services, Inc., controls about 98% of the U.S. market for proxy vote processing. Given this near-monopoly, investors have legitimate reason to question voting accuracy.

13. Should all participants in the voting chain grant access to their share voting records to issuers and their transfer agents/vote tabulators, for the limited purpose of enabling confirmation of a shareholder's vote? What are the benefits and costs associated with sharing such information?

We do not oppose this idea, but we would not embrace it without knowing specifics. There would have to be a feasibility study and cost-benefit analysis. We doubt that raw data would be of any use to issuers, since various parties maintain data in all sorts of forms. The Commission might specify exactly how data was to be submitted, but what are issuers then going to do with all the data? Perhaps Broadridge would develop a service whereby they would analyze the data for issuers, but that returns us to the issue of Broadridge not being an independent third party. Might an entirely independent third party emerge to offer such a service? That is questionable. It is not clear there would be much of a revenue stream to be generated from confirming the occasional vote in corporate elections.

If this concept is deemed to have appeal, we would encourage the Commission not to implement half-measures. Not only will data need to be provided according to uniform standard, but there should be a central database and user-friendly analytics for making queries. Hopefully, both issuers and investors would be able to make queries. The Commission could support such a system as it does EDGAR.

Again, we would not endorse such a system without knowing specifics or without both a feasibility study and cost-benefit analysis. Before the Commission invests significant resources in such an initiative, we would ask if those resources wouldn't be better deployed elsewhere.

Most of the problems with today's proxy system arise because of the current system whereby shares are immobilized by DTC and shareowners trade security entitlements. This system was intended as a temporary stop-gap in the 1970s, when it was implemented. At the time, technology to support an automated direct registration system didn't exist. Today, that technology could easily be implemented. Rather than keep patching the broken-down system of DTC and immobilized stock certificates, perhaps resources should be invested in a comprehensive direct registration system. That would solve many problems with the current proxy system, including that of confirming votes.

14. What is the best way to preserve any continuing anonymity of those investors who choose not to have their identities disclosed to the issuer?

We have serious reservations about allowing anonymous investment in public corporations. We understand this is a foundational issue, but we believe the time is long overdue for public debate on the question.

15. Would the creation of a unique identifier for each beneficial owner be feasible? Would such a system achieve the objective of allowing record owners and beneficial owners to confirm that their vote was cast in accordance with their instructions and confirm the number of shares cast on their behalf? What are the costs and benefits associated with such a system?

We believe that an investor's name and social security number should be sufficient identifiers. Some new system of unique identifiers would serve only to maintain the current system of shareowner anonymity. We do not believe the public interest is served by allowing anonymous investment in public corporations. Before the Commission spends resources implementing some system of anonymous identification, there should be a public debate on the whole issue of anonymous equity investment.

18. Should issuers and securities intermediaries (and their agents) be required to reconcile and verify voting at the beneficial owner level? Would this be consistent with state law, which vests voting rights in the registered owner? Would other reconciliation and verification requirements be consistent with the purposes underlying state law?

Yes, reconciliation should be required. Dematerialization of shares and direct registration, would facilitate the process.

20. Should the Commission 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? If so, how many days would constitute sufficient notice to the public?

We do not consider the practice of securities lending to be in the public interest. We believe the Commission should facilitate substantive public debate on the issue. We encourage the Commission to not facilitate securities lending in any of the ways proposed in the Concept Release. We certainly question the priorities of any shareowner that would "lend" out their securities, very likely for the purpose of vote buying or short selling. Perhaps it would be best if such shareowners didn't vote at all.

28. Does the current fee/rebate structure reflect reasonable expenses? Why or why not? If not, how should these rates be revised?

Such fees and rebates are a source of friction in the proxy system. They are an incentive for interested parties who collect the fees or rebates to oppose reforms. They impair efforts to implement proxy voting platforms for retail investors.

The Commission should, (1) work for greater transparency of fees and rebates, (2) work to have issuers pay fees, (3) reduce instances of such fees or rebates by replacing voting instruction forms (VIFs) with discretionary proxies that shareowners (or proxy voting platforms) can submit directly to an issuer's vote tabulator, and (4) explore how competitive pressures might be bought to bear as a means of reducing fees.

45. Do our existing rules inappropriately inhibit issuers from effectively communicating with investors? If so, what changes should we make to our rules to improve investor communication? Even if our rules do not inappropriately inhibit issuers from effectively communicating with investors, do the rules significantly raise the cost of communicating? Do any non-Commission rules inappropriately inhibit issuers from effectively communicating with investors? What are the benefits and costs of the various changes proposed by commentators?

Yes. Issuers should be given the ability to determine who their shareowners are and have restrictions on their ability to communicate removed.

From the Concept Release:

> There is broad consensus that the enormous volume of transactions cleared and settled in the U.S., which currently involve transactions valued at over $1.48 quadrillion annually, requires a centralized netting facility (i.e., NSCC) and a depository (i.e., DTC) that facilitates book-entry settlement of securities transactions. It is our understanding that this approach to clearance and settlement has produced significant efficiencies, lower costs, and risk management advantages.

An economy in which $1.48 quadrillion in securities trade annually, but corporations don't know who owns them, is frightening.

In an age where computing power scales extremely rapidly the consensus developed in 2000 and published in 2001 is no longer reliable. The centralized netting facility has become an anachronism. The move to direct registration would create efficiencies to allow reporting of ownership at any given point in time, facilitating communication. Issuers having access to ownership should be granted the ability to provide proxy forms to all of their owners, eliminating the need for VIF's. The prohibition on Issuers being able to provide proxy forms to their shareholders has the effect of raising the cost of communication and stemming the flow of additional information. Instituting changes that will allow increased communication will help accomplish the Concept Release's objectives of increasing the accuracy, transparency and efficiency of the voting system. Shareholders could expect to receive shareholder information in a more timely fashion; it may be easier to identify the issuer communicating and will make the system more efficient by eliminating barriers between owners and issuers.

46. Do investors consider the degree and manner of communication with issuers to be adequate?

No, the degree and manner of communication is not adequate. It is perceived that the difficulty issuers have in determining ownership and the added costs to communicate because of the need to use third parties, stifles communication from issuers. With the rapid changes in technology the ability to communicate more effectively, more frequently and with lower cost would benefit shareholders, issuers and markets.

47. To what extent are proxy materials not being delivered in a timely fashion? Are any changes in our rules or other rules required to improve timeliness of delivery, either with respect to registered or beneficial owners?

The drafters of this comment letter have experienced receiving proxy materials after the close of voting. Allowing issuers to provide proxy materials to their owners will greatly improve the timeliness of delivery.

48. What impact does the uniform appearance of proxy materials such as the VIF have on shareholder participation in proxy voting? Would investors, especially retail investors, be more likely to vote if there was less uniformity in the appearance of proxy materials?

It is difficult to determine if a uniform appearance of VIF forms affects participation. However, it is certainly possible the a company being able to better identify themselves of proxy forms makes it easier for shareholders to identify who's proxy they are voting. A retail investor with more than ten holdings in multiple accounts can have numerous elections to cast votes for in March and April. Easier identification of proxy materials will not be a step backwards.

49. Is the format and layout of proxy cards and VIFs clear and easy to use from the perspective of investors? Could the layout be improved to enhance investor participation? Do the formats of proxy cards and VIFs appropriately set out the consequences of not voting or giving voting instructions on one or more specific matters?

Retail investors aren't aware of the restrictions the Commission places on corporate communications. They generally perceive the cryptic proxy materials they receive in the mail to be some sort of arrogant brush-off by corporate lawyers. The message they perceive is that the corporations don't want their participation. They don't realizing issuers have no control over the process.

At a minimum, putting the issuer's name and the deadline for submitting vote instructions prominently on the envelope would be of benefit.

50. To what extent has the loss of broker discretionary votes in uncontested elections of directors increased the likelihood that issuers will not meet quorum requirements? Would the availability of less-costly means of communication with shareholders improve issuers' ability to meet quorum requirements?

We do not believe it is a purpose of the Commission to help corporations achieve quorum. If they had more difficulty achieving quorum, corporations might take more effective actions to attract participation by individual investors in the proxy process.

A more important concern, not raised by the SEC, is the need for shareowners to be able to affirmatively withhold their proxy as an important strategy where shareowners believe the process being followed is illegitimate. The possibility of such an action was raised at Intel in late 2009 after they announced they might hold a virtual-only meeting. See our response to question 10.

51. Do investors have legitimate privacy interests with respect to the disclosure of their share ownership? In what ways would an investor be harmed if his or her identity and the size of his or her holdings are disclosed to issuers? Should an investor be able to indicate that he or she does not wish to be contacted by an issuer? Do broker-dealers or banks have legitimate commercial interests in keeping the identities of their customers confidential? How should these interests be balanced against an issuer's interest in identifying and communicating with its investors? Is this balance different for individual and institutional investors, and if so, would different treatment in regard to OBO status be appropriate? Are there technological solutions that would facilitate communication while protecting the identities of shareholders?

We believe it is in the public interest that individuals not be allowed to finance corporate activities—with their potential to produce enormous good or enormous evil—anonymously. We understand some believe anonymity is important for the conduct of certain speculative trading activities. We are unimpressed and remind the Commission that its mandate says nothing about facilitating speculative trading. To our knowledge, finance theory offers only one argument in support of speculative trading: that it tends to increase liquidity. We have reservations about this claim and note that, if anything, our stock market is too liquid. A little less liquidity might get investors to focus more on good corporate governance and a less on the direction of the Dow.

The OBO/NOBO distinction should be scrapped. Shareowners should not be allowed to refuse direct corporate communications.

53. Are there merits to, or concerns about, establishing a central beneficial

owner data aggregator for use by issuers, as suggested by the Shareholder Communications Coalition and as described above?

There are merits to allowing a data aggregator to compile beneficial owner data. Companies and their shareholders should have equal access to the data. The process would be facilitated by implementing a universal direct registration system.

55. Should we consider rules that would shift the cost of distributing proxy materials to broker-dealers for customers who choose to be objecting beneficial owners?

Yes. This should be coupled with NOBO as the default option when opening a brokerage account. As stated earlier, our preference is for scrapping the OBO/NOBO distinction.

56. Do our rules adequately address how beneficial owners elect objecting or non-objecting beneficial owner status when they open their accounts? Should there be a requirement that beneficial owners' account agreements adopt any specific election as the default choice? If so, would it matter whether the Commission, FINRA, or the stock exchanges imposed that requirement? Should the required default choice be for objecting or non-objecting beneficial owner status? Are there other ways in which default positions can be established for customers of securities intermediaries? Should there be a standardized form for customers to elect either NOBO or OBO status?

We are not aware that brokers typically even mention the OBO/NOBO choice to shareowners opening brokerage accounts. The default option should be NOBO. As stated earlier, our preference is for scrapping the OBO/NOBO distinction.

57. Should we or SROs instead, or in addition, consider requiring securities intermediaries to provide informational materials to their customers prior to allowing the customer to elect OBO or NOBO status? What should be included in such informational materials, and how frequently should investors be provided with such materials? Should we consider requiring securities intermediaries to inform customers of the reasons for and against choosing to disclose or shield their identities?

We believe the OBO/NOBO distinction is not consistent with good public policy. It should be scrapped.

59. Should we consider revising our rules to require that securities intermediaries provide an omnibus proxy to their underlying beneficial owners and identify them to the issuer? If we were to propose such a rule, should we limit it to granting proxies to NOBOs since their identities are already available to issuers? How would such a system address the way securities transactions are cleared and settled?

We support such a solution. Omnibus proxies should cover all shareowners. It would be good to integrate this initiative with efforts to facilitate proxy voting platforms for retail investors.

60. What are the costs and benefits of the annual NOBO system suggested by commentators? Would disclosure of all beneficial owners, limited to information as of the record date of a shareholder meeting, harm those investors (for example, would it reveal trading strategies of those investors)? Would implementing the annual NOBO system adversely affect any privacy interests of OBOs? As a practical matter, would issuers be able to contact OBOs using this information for subsequent shareholder meetings?

Disclosure of all beneficial owners would not harm investors. It should occur more frequently than annually and include information on the length of time shares were held, which would facilitate proving ownership for purposes of Rule 14a-8 and proposed Rule 14a-11. We are not concerned about disclosures impairing speculative trading strategies.

61. What problems might arise if issuers or their transfer agents have greater access to or control of shareholder lists? How could we provide for fair and efficient access to those lists by other soliciting parties?

If corporations moved to block shareholders equal access to the list, this would present a problem. Having the information tabulated by a third party will help ensure that other soliciting parties and shareholders have access. A process similar to a no action letter can be requested by an issuer if an access is deemed inappropriate. A form may need to be developed to request a copy of the list with a copy of the form being provided to the corporation and the SEC. A seven to ten day timeframe for a response would be adequate after a request is made. Excessive costs should not be imposed on shareowners seeking access to the list.

62. To what extent should we take additional steps to encourage retail investor participation in the proxy process?

We believe limited retail investor participation in the proxy process is more a symptom than a problem. The proxy process does not work for retail investors, and retail investors know it. The Commission should take additional steps to encourage retail investor participation only to the extent that such efforts address the problems that underlie the symptom. Some of the proposals in the Commission's Concept Release, if implemented, could be of benefit in this regard. Specifics are addressed in our responses to other questions.

63. To what extent would greater use of plain English, some form of summary of proxy materials, or layered formats in Web-based disclosure make proxy materials more accessible to retail investors?

Allowing proxies to be provided by issuers and better identified as such combined with better explanations of the actions that needed to be taken will help limit any possible confusion.

64. To what extent are retail voter participation levels affected by process-related impediments to participation? If affected by impediments, what are they and should we seek to remove them? What costs and benefits are associated with efforts to increase participation?

Poorly identified VIFs provided by broker-dealers foster confusion. Allowing issuers to provide proxies clearly identified as coming from the issuer will help investors quickly identify the matter as related to a company they have an interest in. It would also be helpful for the Commission to establish guidelines for identifying the beneficial owner or “ultimate investor” entitled to exercise voting rights. For example, full voting rights should be passed to 401(k) plan participants for holdings in the employer's company.

66. Should brokers more clearly highlight and disclose key policies, including a shareholder’s voting rights and default positions, such as OBO/NOBO, when a customer enters into a brokerage agreement? Should brokers provide counseling to potential customers to enhance understanding of such provisions in the brokerage agreement? When a customer enters into a brokerage agreement, should brokers be required to obtain the preferences of the client regarding whether to receive proxy materials electronically, and inform issuers of that election automatically when securities of that issuer are purchased?

We believe the process of opening a brokerage account is complicated enough for most retail investors. Rather than attempting to ensure brokers provide unbiased explanations of the OBO/NOBO decision, we recommend scrapping the OBO/NOBO distinction.

67. What role should the Commission play in promoting or developing the education campaign? How can the SEC's investor education Web sites be made more useful? For example, should the Web site provide interactive instruction?

Some of the content to any educational campaign may logically appear on the SECs website. Numerous not for profit organizations would undoubtedly be interested in developing educational materials that could be housed on the SEC website or be able to be accessed by hyperlink from the SEC website.

68. Would an issuer's Web site or a broker's Web site be a useful location for investor educational information? Are there other methods to effectively educate investors? What would be the costs and benefits of requiring issuers or securities intermediaries to include such information on their Web sites?

Yes, both issuer's and broker's websites are logical locations for investor education materials and both have an interest in encouraging retail investor participation in the proxy process.

70. Should we encourage the creation of inexpensive or free proxy voting platforms that would provide retail investors with access to proxy research, vote recommendations, and vote execution? If so, how?

We strongly advocate that the Commission support the development of free proxy voting platforms for retail investors. New technology or paradigms will encourage participation in the proxy system and improve corporate governance. This initiative should be integrated with that of client-directed voting. If the two are implemented as competing alternatives for shareowners, they will both be diminished. Banks and brokers should not be offering their retail clients options such as "always vote with management", "always vote against management" or "vote according to this third party's recommendations". Rather, they should be offering their clients the single option of transferring their proxy to a voting platform that would then make all the same options—and many more—available to them.

Because the voting platforms would receive proxies—and not VIFs—they could pass client votes directly to vote tabulators, bypassing the expense and inevitable errors associated with passing votes back to the client's securities intermediary and then on to Broadridge. Institutional investors benefit from innovation and experimentation by the proxy voting platforms they use. Retail investors would similarly benefit from such innovation and experimentation by retail proxy voting platforms.

How should the Commission support the development of retail proxy voting platforms? We think a first step is to consider private efforts to date and the obstacles the existing proxy system has imposed on them. Perhaps the most telling example is the for-profit MoxyVote.com platform. Their own comment letter on the Commission's Concept Release is worth quoting at length:

> Presently, the vast majority of institutional investors hold shares at banks/brokers and vote shares through an electronic voting platform. Typically, they pay a fee to the platform provider (e.g., RiskMetrics) who is under contract with the broker's distribution agent (e.g, Broadridge) to receive ballots, gather votes from shareholders and forward votes back to the agent for tabulation. The agent charges the platform provider a fee for submitting votes back to them. So, as would be expected, the platform provider generally passes along this cost to the voting shareholders. Given that these costs are being pushed down to the shareholders, we have a situation where voters are, in effect, paying to submit votes. This set-up presents an inherent flaw in the system that has largely gone un-noticed because the fees are presently not cost-prohibitive to most large institutional investors and, for most of those voters, voting is not optional.
>
> These costs, however, are absolutely devastating to voting platforms that are trying to service retail investors. The fees are typically charged on a per-ballot basis such that an owner of 1,000,000 shares would pay the same to submit a vote as an owner with 10 shares. This fee structure is a barrier to participation by shareholders with smaller positions (i.e., retail voters).

Clearly, without regulatory intervention, the existing proxy system makes implementation of a retail proxy voting platform unlikely. In their letter, MoxyVote.com goes on to suggest the Commission mandate fee schedules for Broadridge. We do not support that solution. As indicated above, we believe the solution is for the Commission to mandate that securities intermediaries give their clients the option of assigning a discretionary proxy to a proxy voting platform of their choice.

We would not limit this to securities intermediaries serving retail clients. It would be an enormous help to institutional proxy voting platforms if they too could receive discretionary proxies they could vote directly with an issuer's vote tabulator, bypassing the Broadridge monopoly.

Another important step for the Commission will be to clarify, once and for all, proxy solicitation rules. In recent years, the Commission has made significant steps to liberalize proxy solicitation rules, especially for shareowner forums and proxy advisors. But much uncertainty remains. That uncertainty is dissuading investment and participation in innovative platforms and solutions. We strongly encourage that rules for shareowner forums, proxy advisors and proxy voting platforms be both simplified and harmonized. Those three structures are more similar than they are different. They pose similar regulatory issues. Inevitably, we anticipate that important innovations will come from hybridizing two or all three into more comprehensive solutions. Uniform regulatory treatment will facilitate this.

The concept of proxy voting platforms receiving proxies from banks and brokers at the direction of clients has been the subject of published articles and much discussion. Many issues and solutions have been addressed—more than can be addressed in a comment letter. See in particular Holton, Glyn A. (2006). Investor suffrage movement, *Financial Analysts Journal*, 62 (6), 15–20 (attached).

71. Should we consider allowing securities intermediaries to solicit voting instructions in advance of distribution of proxy materials pursuant to an exemption from the proxy solicitation rules? Should there be any conditions on any such exemption, and if so, what should they be?

No. While we support innovations in client-directed voting, we believe these should be made available to shareowners through proxy voting platforms and not through instructions to their bank or broker. As indicated in our response to the previous question, we believe the Commission should mandate that banks and brokers give their clients the option to have a discretionary proxy assigned to a proxy voting platform of their choosing. The proxy voting platforms can then facilitate all forms of client directed voting, passing the resulting votes directly to issuers' vote tabulators. A client's election to have such proxies assigned to a particular proxy voting platform should be permanent, effecting their current and future stock holdings, until such time that they provide their bank or broker alternative instructions.

Below, we raise specific concerns about offering various client-directed voting options at the bank or broker level. We focus on some of the specific forms of client-directed voting mentioned in the Concept Release. We do not oppose those specific forms of client directed voting, if they are implemented at the level of the proxy voting platform. Our concerns relate only to the problems that will arise—or become severe—if they are implemented at the bank or broker level.

We have serious concerns about rudimentary forms of client-directed voting that would have shareowners making elections such as "always vote with management", "always vote against management" or "always abstain". We call such rudimentary forms of client-directed voting "zombie voting". If offered on proxy voting platforms along side of more robust options, we believe these rudimentary options would be little-used, posing little problem. If offered at the bank or broker level, as part of only a limited suite of options for client-directed voting, we believe these rudimentary options would be quite widely used, causing systemic problems.

We believe such zombie voting instructions, if widely embraced, would merely window dress the problem of retail investor non-participation. While it may help corporations achieve quorum, we do not believe it is the Commission's role to help corporations achieve quorum. Indeed, if corporations had a more difficult time achieving quorum, they might do a better job of legitimately reaching out to retail shareowners and give them more reason to participate.

We believe that, if widely embraced, zombie voting would destabilize corporate elections and be subject to manipulation, especially by management. For example, if a large block of zombie votes is known to always be cast in opposition to board recommendations, management might find it effective to actually have the board support shareowner proposals they would otherwise oppose. Doing so might cause confusion, but with a little experimentation, management at some corporations might conclude any such confusion was worth the advantage they gained by so-claiming the zombie vote.

As another example of possible manipulation, if a block of zombie votes were known to always be cast in support of shareowner proposals and against management proposals, management might find it convenient to secretly arrange for a third party to submit certain of their proposals, which would then be treated as shareowner proposals for the purpose of deciding the zombie vote.

Another form of client-directed voting mentioned in the Concept Release would allow shareowners to elect that their shares be voted according to recommendations—or pre-announced votes—of some third party. Again, we believe such options would be appropriate if offered through a proxy voting platform. If offered at the bank or broker level, they will pose unique systemic issues. In particular, they will likely lead to violations of Rule 13(d). Let's call the third parties "vote advertisers". If banks or brokers were to cast client votes according to vote advertisers' instructions, the vote advertisers would have the power to "direct the voting of" those clients' shares under Rule 13d-a(3)(a). When a vote advertiser gained a sufficient following to direct 5% of votes for a particular security, Rule 13(d) would require the vote advertiser to notify both the issuer and the Commission. But the vote advertiser would not be able to do so. No one—least of all vote advertisers themselves—will know the number of shares for which any particular vote advertiser is directing votes. Rule 13(d) would be impossible to enforce.

We do not believe any practical reporting system could be implemented to resolve this problem. Presumably, such a reporting system would have banks and brokers reporting to the Commission (or to someone) the number of their clients' votes currently directed by each given vote advertiser. Because Rule 13(d) requires timely reporting, such reports could not go out once a year. They would have to go out continually throughout the year. This would be burdensome on the banks or brokers preparing the reports.

A bigger problem, which we might call "vote scraping"—relates to the barriers to entry for would-be vote advertisers. There are some 13,000 annual meetings held in the United States annually. Coming up with worthwhile voting recommendations for just a fraction of these would be a monumental undertaking. It would require a sizeable staff, with office space and all the overhead expenses associated with running a business. It would cost millions of dollars a year. Such an expenditure wouldn't make sense for a start-up vote advertiser. Few, if any, shareowners would follow their vote recommendations for a few years, so why spend all the money preparing them? A simple alternative would be to borrow some other vote advertiser's vote recommendations. One vote advertiser could go to another vote advertiser's website and borrow—or "scrape"—some or all of their vote recommendations. The cost of launching a vote advertiser that scraped most, or all, of its vote recommendations would be trivial. The cost of launching one that arduously prepared all its own vote recommendations would be prohibitive. Needless to say, start-up vote advertisers would scrape most of their vote recommendations.

Vote scraping will dramatically increase the number of votes that vote advertisers control for purposes of Rule 13(d). A vote advertiser that prepares all its own votes will not only be controlling the votes of shareowners that elect to have their shares voted according to its recommendations, but also of shareowners that elect to have their shares voted according to the recommendations of vote advertisers that scrape its vote recommendations. Any reporting system that tries to capture how many votes a vote advertiser controls may capture the former, but it will not capture the latter. In a nutshell, with a system of vote advertisers, Rule 13(d) will be impossible to enforce.

Simply not enforcing Rule 13(d) with regard to vote advertisers would be dangerous. We fully expect hedge funds or other parties will anonymously fund vote advertisers as a means of controlling large blocks of votes. Let's not go into all the details of how this would work. Suffice it to say that a system of advanced voting instructions that utilizes vote advertisers would lack transparency, would be beyond the reach of Rule 13(d), and would be ripe for abuse.

These problems would not arise if a similar form of client-directed voting were implemented via proxy voting platforms. Rule 13(d) would be easy to enforce. Reporting would have to occur throughout the year, but once a year, those reports would be reconciled with the actual votes each vote advertiser controlled through the proxy voting platforms. The information could easily be obtained from the proxy voting platforms, instead of being in the hands of thousands of dispersed banks and brokers. More importantly, vote scraping would be impossible. If vote advertisers' voting recommendations were implemented through banks and brokers, those recommendations would have to be posted to their websites in a form that would be easy for the banks and brokers to scrape. On the other hand, if vote advertisers' voting recommendations were implemented through proxy voting platforms, they could communicate their recommendations directly to the proxy voting platforms in bulk form. They could still publicly distribute those recommendations on their websites, but they could do so with a query-based interface that could not be scraped.

As we indicated in our response to the previous question, the concept of proxy voting platforms receiving proxies from banks and brokers at the direction of clients has been the subject of published articles and much discussion. Many issues and solutions have been addressed—more than can be addressed in a comment letter. See in particular Holton, Glyn A. (2006). Investor suffrage movement, *Financial Analysts Journal*, 62 (6), 15–20 (attached).

81. Have electronic shareholder forums been used extensively? Are there any revisions to Rule 14a-2(b)(6), which currently provides an exemption for electronic shareholder forums, that would make it easier to establish such forums? For example, is there a way for an entity establishing an electronic shareholder forum to confirm the shareholder status of participants on the forum? If a securities intermediary provides information, such as a control number, to enable such confirmation, should precautions be taken to ensure that personal information about those investors is not disclosed?

No. Shareholder forums have not been used extensively. Rule 14a-2(b)(6) should be revised to provide for discussion of issues related an issuers proxy up to the date voting closes. Proxy solicitation rules need to be revised and clarified to allow investors more freedom to discuss who they plan to vote for and encourage others as to how they should vote. The forum should be open to all shareholders and registering as a shareholder forum and inclusion as such in an issuers proxy statement would provide public notice that a forum exists. Forums could register in the same fashion that a shareholder proposal is submitted to an issuer. A section in the proxy titled Shareholder Forums, explaining that a forum is available and its purpose along with a internet address would be sufficient. It is not necessary to limit participation to shareholders. Potential investors, employees and former shareholders are examples of constituencies that may be able to provide valuable input.

82. Should we consider revising the electronic shareholder forum rules to shorten the 60-day period to promote more shareholder-to-shareholder communication closer to the meeting date? If so, what would be an appropriate time period?

Yes, the 60 day rule should be shortened to put investors on equal footing with the issuer. The communication should be allowed up to the meeting date.

84. Would any additional guidance regarding the scope of our rules and definitions, such as the definition of the term "solicitation," improve the extent and quality of investor participation in the proxy voting process?

Clarifying soliciting proxies and how that is interpreted in a shareholder forum would greatly improve shareholder's ability to participate in a shareholder forum. Discussion in a forum would lead to greater interest in the proxy process.

86. Should we consider amending our rules to permit inclusion of a proxy card or VIF with a Notice of Internet Availability of Proxy Materials?

Yes. A proxy provided by the issuer and clearly identified as from the issuer would help improve the clarity of the process for retail investors. We believe all VIFs should be replaced with discretionary proxies.

88. Should we permit issuers, including funds, to provide proxy statement and voting information to the Commission and on their corporate Web sites, if any, in an interactive data format? If so, are there benefits to one tagging language (e.g., XBRL) over another? Should we require issuers to provide such information to the Commission and on their corporate Web sites, if any, in an interactive data format? Should we also permit or require the tagging of executive compensation information even if it is not in the proxy statement, but rather, in the annual report on Form 10-K?226

The SEC should implement the recommendations of its own Investor Advisory Committee *Resolution on Proxy Voting Transparency*, passed unanimously at the 2010-02-22 IAC meeting,[1] regarding data-tagging in the following specific filings and should mandate as soon as is feasible:

1. Proxy filings (DEF 14A). Especially useful for investors would be the information disclosed regarding directors (such as other board service, executive roles, affilations / transactions with the company, committee memberships, etc.), governance attributes of the firm, compensation data, peer groups, audit information, key accounting issues and the details of each item to be voted on. This would facilitate a variety of investor search purposes, including better information on which to make voting decisions, enhanced ability of shareholders to assess the role of directors across the public markets, improved opportunity for investors to compare and contrast important governance attributes across firms and track changes in governance trends and automated matching of voting items in a proxy filing to votes in N-PX filings. The same standardized tag-data format could then also be used for sharing anyone's voting opinions in real-time Open CDV systems.

[1] http://www.sec.gov/spotlight/invadvcomm/iacproposedresproxyvotingtrans.pdf

2. N-PX filings of mutual fund votes. The Commission does not now specify technical formats for release of N-PX filings. As a result, fund companies produce text files in multiple layouts. Standardization using a tag data format would permit investors and third party market bodies to make voting data available to the public in convenient and intelligible ways at reduced costs. Format inefficiencies have frustrated the fundamental goal of this disclosure requirement.

3. Corporate filing of voting results. These are now in 8K filings in untagged text format. The costs of developing common taxonomies for tag formatting should be borne by the industry or a private sector body rather than the SEC itself. Tag formatting can reduce error rates inherent in processing various text formats that may change from time to time. It would also facilitate research on mutual fund voting, such as these two articles by University of Chicago Professor Gregor Matvos and Stanford University Professor Michael Ostrovsky: "Cross-Ownership, Returns, and Voting in Mergers," *Journal of Financial Economics*, v.89(3), September 2008, pp. 391-403 and "Heterogeneity and Peer Effects in Mutual Fund Proxy Voting", *Journal of Financial Economics*, forthcoming. These authors concur that a standardized, computer-readable format for voting data would make further research much easier in future.

89. Are there any other types of information for which we should permit or require tagging in order to improve the efficiency and quality of proxy voting? For example, should we permit or require tagging of information contained in proxy statements filed by non-management parties?

Unless provided by non-management parties, management should be required to data tag information contained in proxy statements filed by non-management parties and should be required to do so in an unbiased fashion.

90. If we permit or require interactive data for the information contained in a proxy statement, should we permit or require it for only a subset of that information, such as executive compensation, director experience and other directorships, transactions with related persons, or corporate governance? Should we permit or require it for only a subset of executive compensation information, such as the Summary Compensation Table, Director Compensation Table, Outstanding Equity Awards at Fiscal Year-End Table, or Compensation Discussion and Analysis?

First priority should be given to proxy items to be voted; second priority to supporting documents.

91. Would it be useful to investors for issuers to provide their proxy statement and voting information, or some subset of that information, in interactive data format? If so, would it be useful for issuers to provide the information both to the Commission and on their corporate Web sites, if any? Would data-tagging enable investors to access proxy information more easily or to compare information regarding different issuers and/or changes in information over time with respect to a specific issuer or a set of issuers? Would this ability result in better informed voting decisions?

Issuers should be encouraged to provide interactive proxy statements on their websites. Many do so already, to a limited extent.

93. Is it feasible for funds to tag Form N-PX in a manner that provides for uniform identification of each matter voted (e.g., for every fund to assign For instance, should officer and director identities be tagged and linked to their unique Commission Central Index Key (CIK) identifier, which would enable investors to more easily determine whether they have relationships with other Commission filers? Would investors benefit if governance attributes, such as board leadership structure and director independence, were tagged?

See above.

98. Whether or not we permit or require interactive data tagging, should Form N-PX require standardized reporting formats so that comparisons between funds are easier?

Yes.

99. Should persons other than the issuer be required to file proxy materials in interactive data format?

No. Not yet.

100. How will retail investors have access to interactive data/XBRL software that will enable them to take advantage of interactive data formats?

Through third party providers.

102. Is additional regulation of proxy advisory firms necessary or appropriate for the protection of investors? Why or why not? If so, what are the implications of regulation through the Advisers Act or the proxy solicitation rules under the Exchange Act? Are any other regulatory approaches equally or better suited to provide appropriate additional regulation? Are there regulatory approaches used in connection with NRSROs that may be appropriate to consider applying to proxy advisory firms?

Because proxy advisors, proxy voting platforms and shareownr forums play overlapping roles, we believe their regulation should be harmonized. Rules that apply to one should easily translate into—or be identical to—rules for the others.

We support the registration of proxy advisory firms and full disclosure of conflicts of interest, but oppose regulatory involvement in methodologies used by proxy advisers to determine vote recommendations. Additionally, as pointed out in the comments of Glass-Lewis, we do not believe proxy advisors should register as investment advisors under Advisers Act Section 203A(c). In our view, research reports that discuss the issues presented for shareholder vote in proxy statements, and accompanying voting recommendations, generally would not meet the elements of "investment advice" spelled out in Section 202(a)(11) of the Investment Advisers Act of 1940.

111. How do institutional investors use the voting recommendations provided by proxy advisory firms? What empirical data exists regarding how, and to what extent, institutional investors vote consistently, or inconsistently, with such recommendations?

Contrary to the impression given in the Concept Release, proxy advisory firms do not typically impose a single set of guidelines or recommendations. Instead, they offer custom solutions that apply the investors' own set of guidelines. Furthermore, advisory firms' recommendations are considered carefully by their clients and are not always followed. Institutional investors regularly review the reasoning provided for the recommendation, collect input internally and then make their voting decision.

133. What is the potential for, and actual prevalence of, all forms of equity, debt, and hybrid decoupling (including empty voting)? Are these techniques employed differently by "outside" investors, company insiders, and the company itself? Does decoupling raise public policy concerns, for example in relation to the disclosure requirements of Section 13(d)? Are existing disclosure requirements under Section 13(d) and other provisions of federal securities laws sufficient to address the entire range of concerns raised by equity, debt, and hybrid decoupling?

A University of Pennsylvania study of stock lending patterns at two major banks found abnormally large stock loan volume on voting record dates, particularly so with regards to proposals of lagging firms with close votes, and for management proposals related to compensation. (Christoffersen, Reed, Geczy, and Musto, The Market for Record-Date Ownership, 2002). A separate study cited in *Money for Nothing* (Gillespie and Zweig, 2010) conducted by a trade association of stock transfer agents, found evidence of duplicate voting in 100% of a sample of 341 shareholder votes in 2005. Gillespie and Zweig also reference the following instances of ostensible empty voting: El Paso Corporation's 2003 annual election of directors in which a slate of nine dissident directors were beaten by a margin of just 2.8%; the authors point out that 13% of shares in El Paso, "an enormous volume," were borrowed just before said election; French insurance giant AXA Financial wins shareholder approval by only 1.7 million votes to takeover Mutual Life Insurance Company of New York in 2004 after an eight-month battle—however, just prior to the vote, 6.4 million shares were loaned.

134. Can the potentially beneficial and potentially detrimental aspects of debt, equity, or hybrid decoupling be meaningfully distinguished? Are there adverse consequences if there are empty voters, or even empty voters with negative economic interests, especially if their votes are outcome determinative? Are there examples of situations in which empty voting was outcome determinative?

The research we have seen suggests that the decoupling is entirely detrimental and that not only can it not be meaningfully distinguished, it may not even be known to shareholders unless appropriate Section 13(d) filings are made.

135. What are the mechanisms that result in debt, equity, and hybrid decoupling giving rise to public policy concerns? How important are these different mechanisms? To what extent can credit derivatives, correlated assets (such as, for example, shares of other participants in a takeover battle), or other financial instruments be used, and to what extent are they being used, to accomplish empty voting? To what extent does debt decoupling raise issues similar to those raised by equity decoupling or hybrid decoupling and how might regulatory or other responses to debt decoupling differ?

We consider the Concept Release's explanation of how empty voting might arise in a corporate acquisition so convoluted as to be uninteresting. As a practical matter, the risk associated with whether or not the merger would go through would swamp any risk associated with whether or not the acquiring firm might over-pay.

We do believe that certain credit derivatives might be sufficiently correlated with an issuer's share price as to facilitate empty voting. We believe the Commission should seek authority from Congress to outlaw credit derivatives.

136. At what economic threshold or percentage of voting power threshold is decoupling—by any one individual, by group, or by shareholders in the aggregate—material to the company and its security holders?

Given that close elections are not uncommon, the threshold is very low. In fact, since management is conceivably capable of, and in practice does, influence the votes of institutional investors, it is not unreasonable to assume that empty voting is material to the outcome of any given election or proposal.

139. Under what circumstances should disclosure of a shareholder's net economic interest be required, along with any associated decoupling? If such net economic interest is required to be disclosed, how should "net economic interest" be defined, given the myriad ways in which such decoupling can occur? Should our rules require disclosure regarding, and/or certification of, beneficial and economic ownership as part of the form of proxy or VIF? Or should this matter be left to state law or bylaws adopted by individual companies?

At a minimum, we believe that any existing or a new disclosure under Section 13(d) should necessitate the disclosure by investors of any existing or future decoupling. Further, said disclosure of decoupling should favor transparency, and quantitative details, as opposed to a mere acknowledgment (yes/no) of engaging in some form of decoupling.

141. Are there circumstances (such as empty voting while holding a negative economic interest) where debt, equity, and hybrid decoupling appear to be fundamentally detrimental to the shareholders, debtholders, or the issuer itself? Are existing disclosure requirements, or changes to existing disclosure requirements, sufficient to address any such concerns? Should the Commission consider additional remedial actions? What role should federal law, state law and individual corporate actions play in addressing any such concerns?

Empty voting is entirely detrimental to the public interest, despite strained attempts to suggest otherwise. To the extent that it arises from speculative tools, we believe the Commission should prohibit those tools or seek authority from congress to prohibit them. Such tools include equity short selling and the associated device of equity securities lending. All equity derivatives are inherently speculative. Unlike commodities, where manufacturers or consumers may be forced to take positions they need to hedge, equity derivatives are inherently speculative. If you want to hedge an equity position, sell the equities. Conceivably, equity derivatives might be used to reduce equity exposure while avoiding capital gains taxes. We would, however, agree with the Internal Revenue Service that such use is inappropriate.

In the course of a single decade, our economy has experienced two market-induced meltdowns unlike anything since 1929. Some investors are concluding that our stock market has become a form of casino capitalism. The Commission needs to choose which is more important: speculative trading or honest corporate elections.

We strongly advise the Commission, for the public good, to (1) outlaw equity short selling and equity securities lending and (2) seek from Congress authority to outlaw all forms of equity derivatives. Shareowners who liquidate equities between the record data and annual meeting should not be allowed to vote those liquidated shares.

We appreciate this opportunity to comment. We hope our feedback is helpful, and we welcome an opportunity for further dialogue on these important issues. Our executive director, Glyn Holton, can be reached at (617) 945-2484 or mail@glynholton.com.

Sincerely,

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PERSPECTIVES

Investor Suffrage Movement

Glyn A. Holton

During the past 100 years, capitalism has been transformed. No longer is corporate America owned by Morgans, Rockefellers, and Carnegies. It is owned by average Americans through mutual funds, pension plans, and direct stock ownership. This is called "democracy of capitalism," but something is missing. For democracy to work, people must vote. In the democracy that U.S. capitalism has become, individuals do not vote the shares they own. This can be attributed to:

- *Rational apathy*. Individual holdings are too minuscule to justify the effort required to vote the shares, and most individuals lack the expertise to constructively do so anyway.
- *Institutional ownership*. Investors who beneficially own shares through mutual funds, pension plans, and other intermediaries are denied the right to vote those shares.

To reassert control over the corporations they own, shareholders must overcome these obstacles. They can do so by implementing a novel "proxy exchange" that allows them to conveniently secure, transfer, aggregate, and exercise voting rights.

A Simple Change

Imagine a woman who is a successful employee, an investor, and a mother. Between the demands of work and shuttling her kids to sports practice, she cares about her world. She worries about damage to the environment. She is troubled by explicit sex and violence portrayed on television—and the impact it has on children. Paradoxically, she owns the companies that pollute the environment and the media. During a successful career, she has accumulated savings, which she has invested in equity index funds. The woman owns a slice of corporate America—and there are a million other moms like her. Collectively, they have the economic clout to shape corporate behavior. But this is hypothetical.

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Scrambling from a planning meeting to soccer practice, the woman doesn't think such thoughts. On the car radio, an announcer describes the latest indictments in the latest corporate scandals—more names to join Enron, WorldCom, Tyco . . .

Let's change this picture. Let's make one minor modification to the woman's world and see where it leads us. Suppose the woman receives a letter from her mutual fund company reminding her that her mutual funds vote the shares they hold on her behalf. She has never had a choice about this, but the letter now offers her one. She can have the mutual funds continue to vote the shares, or the voting rights can be assigned to an organization of her choosing—perhaps a charity involved in environmental or children's issues.

The letter goes on to explain that her fund company, cooperating with other institutions, has established a "proxy exchange." This is like any other exchange except that it is not for trading stocks or futures. It is for transferring voting rights. Use of the exchange is free, and the woman can access it through a secure website. She can transfer her voting rights to anyone she chooses—anyone willing to accept them.

What will the woman do? If she and a million moms like her choose to transfer voting rights to charities, professional associations, investment advisers, advocacy groups, and other organizations, what will happen? What will those recipients do with their new economic power? How will capitalism be transformed?

Managerial Capitalism

The agency problem has existed as long as people have allowed others to act on their behalf. In corporations, it arises between shareholders and managers, and this was one of the reasons Adam Smith (1776) denounced corporations. Commenting on managers, he complained:

> . . . being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the

partners of a private copartnery frequently watch over their own. . . . (1776, Book V, ch. I, part III, article 1)

Writing 150 years later, Berle and Means (1932) noted a fundamental change in the agency problem. Stock ownership of large corporations was becoming widely dispersed. This was democracy of capitalism, but it meant that individual holdings were shrinking. Shareholders were losing influence over managers. Berle and Means wrote:

Under such conditions, control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding. (1932, p. 8)

Berle and Means were witnessing the beginnings of a phenomenon called "managerial capitalism."[1] In Adam Smith's day, shareholders still held sway over managers and the agency problem was a matter of managers not exercising "anxious vigilance." Under managerial capitalism, shareholders have lost control of managers and the agency problem is one of managers enriching themselves to the extent applicable laws allow. Berle and Means identified a variety of devices by which managers might enrich themselves at the expense of owners. Laws have evolved since their time, but similar methods still exist. Perhaps the most straightforward is for managers to pay themselves exorbitant compensation.[2]

Fiduciary Capitalism

In parallel with managerial capitalism, another phenomenon has emerged that we might call "fiduciary capitalism."[3] This is ownership of equities by intermediaries, such as mutual funds, pension plans, and insurance companies. As **Table 1** shows, these institutions hold about half of all U.S. equities. By inserting themselves between corporations and investors, they further isolate managers from those investors. As large shareholders, institutions could challenge managers for the benefit of investors, but few engage in such shareholder activism.

Among institutions, public pension plans—that is, plans that manage assets for the benefit of public servants—have been the most activist. They have had some success convincing boards to implement corporate governance reforms. They are respected for playing this role, but their actions have been measured—more "shareholder engagement" than "shareholder activism." As public entities, they are subject to political pressures. If they became more aggressive in shareholder activism, they might be accused of being antibusiness. Even if they were to become more activist, their impact would be limited because they hold just 7.5 percent of corporate stock.

Table 1. Recent Evolution of U.S. Equity Holdings by Type of Investor

Investor Type	1995	1998	2001	2004
Individual investors	51.3%	48.1%	45.0%	39.4%
Mutual funds	12.6	16.5	19.3	23.1
Foreign investors	6.5	8.0	10.3	11.2
Private pension funds	15.1	12.5	10.2	9.8
Public pension funds	8.4	7.9	7.4	7.5
Insurance companies	5.2	5.7	6.4	7.4
Other	0.9	1.2	1.5	1.5

Notes: Calculated from Federal Reserve Board (2005, p. 82) data. Percentages indicating the fraction of U.S. equities held by each category of investor are based on market values. Because of how the Fed reports numbers, equity holdings include all U.S. company stock and foreign company stock (including American Depositary Receipts) held by U.S. investors. "Individual investors" includes bank personal trusts and estates. "Mutual funds" includes closed-end and exchange-traded funds. The "Other" category includes holdings by investment banks, brokers, and other financial institutions and domestic government holdings not included under public pension funds. The "Foreign investors" numbers are biased downward by the fact that this category does not reflect holdings of foreign stocks whereas other categories do. In 2004, foreign stocks represented 13.9 percent of the total holdings considered.

Other institutions have exhibited little or no shareholder activism. Corporate pension plans and insurance companies are controlled by corporate managers, so most are unlikely to engage in shareholder activism.

The situation of mutual funds is more complex. During the market declines of 2000–2002, mutual fund companies lost earnings and had to lay off staff. They would welcome reforms that might avoid market turmoil in the future, but most funds hesitate to be activist themselves. The primary reason is that they do not want to jeopardize existing or potential client relationships. Many mutual fund companies sell asset management services to corporations, and they avoid shareholder activism that might antagonize managers of those corporations. Some mutual fund companies are parts of larger financial institutions, and shareholder activism on their part might imperil sales of investment banking, brokerage, insurance, custody, and other services.

At the same time, pressure is mounting on mutual funds to become more activist. Over the past 10 years, mutual funds' proportion of U.S. equity holdings has almost doubled. The U.S. SEC has implemented a new rule requiring them to disclose how they vote shares. Mutual funds have the economic power to engage in productive shareholder activism, and now the public is watching. A failure to comply poses the reputational risk of appearing to coddle entrenched corporate managers.

For mutual fund companies, having to vote shares is a lose–lose situation. They lose if they are activist; they lose if they are passive. The fund companies would like another alternative—and that is what a proxy exchange offers.

A Proxy Exchange

To understand how a proxy exchange would work, let's return to the woman who just received the letter from her mutual fund company. Intrigued, she decides to assign her voting rights to a particular charity that is involved in children's issues. At her computer, she locates the website of the proxy exchange. After entering identifying information, she is taken to her own account page. The account has already been established for her by her mutual fund and brokerage firms. Those firms have the legal right to vote shares that they hold on her behalf, but they have placed the voting rights in her account.[4] She can do with them as she pleases. If she is so inclined, she can access relevant shareholder materials online and actually vote her shares through the exchange. The exchange has an advanced set of screens that will allow her to do precisely that. More-basic screens allow the woman to simply transfer all her voting rights to a third party.

Using those screens, the woman searches for her charity and confirms that it is willing to accept voting rights. With a single mouse click, she transfers all her rights to the charity. Her selection is not permanent; she can change it at any time. Until then, the charity will continue to receive all rights deposited into her account.

What will the charity do with the rights? Actually, it is in the same position as the woman. It has an account with the exchange, and voting rights are being deposited into it—from the woman's account and perhaps from a thousand other accounts. If the charity receives a large volume of rights, it may devote resources to voting them. If not, it can transfer them on to a trusted third party. Through the exchange's intermediate-level screens, the charity has even more options. For example, it might choose to vote shares of companies whose activities affect children but transfer the rest of its rights to another charity.

Rights may pass through many hands before they end up in the account of a party with sufficient rights to justify the effort to constructively vote them. The entire process will be one of aggregation. Through an exchange, small blocks of rights will be aggregated into medium blocks, which will be aggregated into large blocks. Large blocks will be voted through the exchange.

Four classes of participants can be identified:

1. *assigners*: institutions such as mutual funds, brokerages, and pension plans that legally assign proxy rights to the exchange;
2. *beneficiaries*: the beneficial stock owners—primarily individual investors—on whose behalf those rights are assigned to the exchange;
3. *aggregators*: anyone willing to accept rights from beneficiaries or other aggregators through the exchange;
4. *voters*: parties who ultimately make voting decisions.

Some participants will be members of more than one class. For example, suppose a woman and her father are both investors in a mutual fund. The fund assigns its proxy rights to the proxy exchange and identifies the woman and her father (along with other investors) as the beneficial owners. The father transfers his rights to the woman. She then transfers their combined rights to a charity, which votes the shares. In this case, the mutual fund is an assigner; the father is a beneficiary; the woman is both a beneficiary and an aggregator; and the charity is an aggregator and a voter.

Transferring, aggregating, and/or voting rights could be done by anyone who chooses to—charities, professional associations, trade unions, advocacy groups, investment advisers, faith-based organizations, retirees who do so as a hobby—anyone. An online community may develop. Tips and ideas would be exchanged. Upcoming votes would be discussed. Referrals would be made, as in, "You want to unload your IBM? Give 'em to Joe. He knows the company inside and out, and he thinks the way you do. Check out his record."

Legal Issues

Shareholders have a legal right to appoint an agent—a proxy—to vote shares and otherwise act on their behalf. Historically, this right allowed shareholders who were unable to attend a corporation's shareholder meeting to still exercise their rights as owners.

Shareholders can dictate how a proxy is to act on their behalf, or they can leave that decision to the proxy. Today, the notion that shareholders can select their own proxy resembles the remark attributed to Henry Ford that people can buy any color of Model T they want—so long as it is black. Before each annual meeting, managers mail to shareholders proxy assignment cards allowing them to appoint those same managers[5] as their proxy. That is the only choice the cards offer—take it or leave it.

The system is so broken down that managers seek proxy rights more to ensure a quorum at the shareholder meeting than out of fear that they might actually lose a vote. Only in rare circumstances does a proxy fight arise in which a competing group also sends out a mailing to shareholders soliciting a grant of proxy rights. That situation is akin to offering automobiles that are either black or gray.

A proxy exchange will allow shareholders to select anyone they like to exercise their voting rights. It may appear that each transaction on the exchange will be a legal assignment of proxy rights. Intuitively, an exchange will work that way, but a cleaner legal mechanism is available for achieving the same result.

Legally, a proxy exchange will serve as the proxy for everyone. It will hold all proxy rights, and it will exercise those proxy rights according to the instructions of the beneficiaries. If a beneficiary chooses to vote her own shares, the exchange will vote the shares according to her instructions. If she uses the exchange to transfer her voting rights to an aggregator, the transaction will legally be nothing more than her instructing the exchange to exercise the proxy rights on her behalf according to the aggregator's instructions.[6]

Although transactions on a proxy exchange will not legally be assignments of proxy rights, exchange rules can largely treat them as if they were. Those rules may be written to comply with the spirit, if not the letter, of state and SEC regulations and case law governing assignments of proxy rights. For example, the purchase or sale of voting rights raises public policy issues, so an exchange should not facilitate such transactions.

Disclosures

In its operations, a proxy exchange will have to balance competing needs for disclosure and privacy. For example, a trade union might—with entirely good intentions—encourage its members to assign their voting rights to the union. Union members who did not comply might not want the union to know of their decision. For this and similar reasons, the exchange should not disclose to aggregators who is transferring rights to them.

Larger aggregators' voting records should be disclosed with both summary reports and details of individual votes. An aggregator might add comments to its record explaining individual voting decisions. If an aggregator transfers voting rights to another aggregator, its record can reflect how the votes were ultimately cast.

How might someone use an aggregator's record? Consider again the woman who has just assigned her rights to a charity that focuses on children's issues. Having made her selection, the woman is about to exit the exchange's website when a thought occurs to her: Sure, she cares about children's issues, but she is counting on her investments to provide income in retirement. What if the charity acts recklessly—voting shares without considering financial consequences for shareholders?

The exchange's reporting functionality is intuitive, so the woman easily calls up a summary report comparing the voting record of the charity with one of her mutual funds. She is pleased to find that they vote the same way 86 percent of the time. She calls up a list of votes on which they have acted differently. In most cases, the charity's vote has an accompanying explanatory comment in the report. Some notes relate to social issues. Many focus on financial issues; for example, the charity may have voted against a board member because of poor performance of other corporations whose boards he sits on. The mutual fund has entered few comments accompanying its votes. Reassured that the charity is acting responsibly—both socially and financially—the woman leaves her selection unchanged.

Agency Costs

Agency theory tells us that board members, managers, and aggregators will not make the personal commitment their roles require unless they get something in return. They are going to pursue, to some extent, their own private agendas. This is what economists call an agency cost.

Does it matter what the private agenda is? Often, in the case of a board member or manager, the private agenda is to secure perquisites out of corporate resources, but other agendas are possible. Is there any real difference between

- a board member who acts generally for the financial benefit of shareholders so he can pursue his own agenda of securing perks for himself and
- a board member who acts generally for the financial benefit of shareholders so he can pursue his own agenda of getting corporate money out of politics?

Both agents have private agendas that are inconsistent with maximizing shareholder value. Both strive to benefit shareholders so they can retain their positions and continue to pursue their private agendas. Their respective private agendas are agency costs.

A proxy exchange will attract numerous aggregators prepared to work diligently for the benefit of shareholders because they want to pursue their own agendas. They will compete for beneficiaries' voting rights based on *quality* (their perceived ability to maximize shareholder value) and *price* (the perceived magnitude and nature of their agency costs).

Some aggregators will have private agendas that appeal to shareholders, and they will advertise those agendas. Others will have more selfish agendas, which they will not want to advertise. All aggregators will promote their own ability to make sound decisions for the financial benefit of shareholders. Competition among aggregators will flourish. This will squeeze agency costs, minimizing the ability of aggregators to pursue their private agendas while driving all aggregators to work for the financial benefit of shareholders.

A proxy exchange will be a new market for corporate control—a market more efficient and far less costly than hostile takeovers or traditional proxy fights. Through competition, a proxy exchange will do a better job of minimizing agency costs and maximizing shareholder value than the "self-perpetuating body" of managerial capitalism ever can.

Implementation

Democracy is a controversial idea. Thomas Jefferson observed, "A democracy is nothing more than mob rule." Later, Winston Churchill would share his concern, commenting, ". . . democracy is the worst form of government except all those other forms that have been tried from time to time." This, I think, is the essential argument in favor of democracy. Giving power to the masses is frightening, but giving it to anyone else is more frightening.

Mob rule shouldn't be an issue with a proxy exchange. One reason is that the democracy of capitalism is an elitist democracy. Instead of one person, one vote, it works according to one share, one vote. With influence proportional to each person's stock holdings, the wealthy have an advantage—and they tend to be better educated than the general population.

Social agendas will be pursued through a proxy exchange, but they will be fragmented. A few with broad popular appeal may meet with some success, but they will have a moderating influence over corporations rather than a controlling one. A truism of politics is that Americans "vote their pocketbooks." If concerns ever arise about the influence interest groups are having on corporate America, we can expect average Americans to flock to a proxy exchange to "set things right."

No regulatory impediments preclude the launch of a proxy exchange. Legally, the exchange will be nothing more than an organization that makes itself available to serve as a proxy for others. Exchange rules and technology for transferring rights among participants do not need to be immediately implemented. They might evolve as the exchange grows.

A nominal exchange could be launched by activists who simply instruct their stock brokers to assign their proxy rights to the exchange. The activists could then "transfer" voting rights among themselves over hot chocolate in someone's living room. At that point, voting decisions would matter less than the fact that those decisions were actually being made through the exchange. As a novel concept unanticipated by existing regulations, such a proxy exchange would quickly introduce itself into gray areas of corporate governance regulations. It could become a useful vehicle for spawning legal test cases and highlighting the unfortunate state of shareholder rights under managerial capitalism.

There are many avenues by which a fully automated proxy exchange might be implemented. A foundation or wealthy philanthropist might donate money to launch an exchange. Various for-profit and not-for-profit organizations are involved in proxy issues and corporate governance. If they pooled their resources, they could form an exchange. A for-profit firm might launch an exchange as a business venture, earning income by charging fees from assigners. If regulators conclude that the marketplace has failed to develop a mechanism to facilitate the free granting of proxy rights, they might encourage financial institutions to form a proxy exchange.

Still another avenue would be for mutual fund companies to serve as a proxy exchange for their own clients. This would be easy because the funds already hold the proxy rights. Legally, such a proxy exchange would be nothing more than a formalized vehicle for the funds to solicit clients' advice on how to vote shares—and then act on that advice. This would be simple and inexpensive to implement. Any mutual fund company that wants to distinguish itself from competitors would be shortsighted not to implement it.

Clearly, there are many avenues for implementing a proxy exchange. If several initiatives develop, they can compete with and learn from one another. When they mature and operations become standardized, they might merge to achieve economies of scale.

Conclusion

Recent market crashes and financial scandals are symptomatic of a capitalism in which shareholders have lost control over the corporations they own. U.S. law recognizes shareholders' right to exercise control through a proxy of their choosing. But because there has been no practical way to facilitate it, shareholders have been denied this fundamental right.

The result is managerial capitalism. Its costs—fraud, diversion of resources, cronyism, and just plain mediocrity—are incalculable. Legislative responses like the Sarbanes–Oxley Act of 2002 do some good, but they also impose significant costs. Rather than reform managerial capitalism, a proxy exchange will eliminate it. It is a market-based solution that will work through the simple device of putting owners back in charge. Investors will benefit; financial institutions will benefit; and society as a whole will benefit.

Democracy of capitalism is a wonderful thing—if we can get it working. We need an investor suffrage movement. A proxy exchange will launch it.

This article qualifies for 0.5 PD credit.

Notes

1. The term was coined by Chandler (1977).
2. Bebchuk and Fried (2004) discussed management compensation specifically. Monk and Sykes (2002), MacAvoy and Millstein (2004), and Lorsch, Berlowitz, and Zelleke (2005) addressed the corporate governance problem generally.
3. Hawley and Williams (2000) used this term. See also Rubach (1999).
4. If a brokerage holds stock for investors in a street name, those investors may instruct the brokerage on how to vote the shares.
5. More precisely, the card allows shareholders to appoint a party who is *answerable* to the managers.
6. In this article, I use the expression "proxy rights" when a proxy is being assigned under applicable laws or regulations. I use the expression "voting rights" when a similar assignment is made under the exchange's rules. These rights are identical rights to act on behalf of the shareholder, which (in theory) could involve more than mere voting, but their legal bases differ.

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