BNY MELLON
DEPOSITARY RECEIPTS

October 20, 2010

Elizabeth M. Murphy

Secretary, Securities and Exchange Commission

100F Street, NE

Washington D.C. 20549-109

File Number: S7-14-10

Dear Ms Murphy,

Re: Concept Release on the U.S. Proxy System

As a leading depositary bank, we have consulted with members of our European Client Council (the "Council") in order to ascertain their collective views in formulating this response to the Commission's Concept Release on the U.S. proxy system (the "Release").

Below is a list of issuers, many of whom are also listed on the New York Stock Exchange or NASDAQ, who are in broad agreement with the views expressed in this letter.

- Anglogold Ashanti Limited;
- ArcelorMittal;

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- ARM Holdings plc;
- Aviva plc;
- Bayer AG;
- BP plc;
- GlaxoSmithKline plc;
- HSBC Holdings plc;
- National Grid plc;
- Reed Elsevier plc;
- Rio Tinto plc;
- Royal Dutch Shell plc;
- Smith & Nephew plc;
- Standard Chartered plc
- Total S.A.; and
- UBS AG.

We have chosen to group our comments under two categories: general comments about the current proxy system market infrastructure and the principles and possible alternatives we believe should govern its future development; and specific comments that relate to one or more of the areas the Commission has identified for closer examination in the Release. We have adopted the heading titles used by the Commission in the Release for ease of reference.

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1 General Comments

1.1 Introduction

In evaluating the totality of the Release, we believe the Commission has identified many anomalies within the current proxy voting system that cause material and costly negative external effects. Fundamentally, we believe this requires a close examination of the efficacy of the system and its current fitness for the purpose of achieving the level of accountability that the material users should properly expect for serving and supporting their needs and expectations. In undertaking this examination, we believe the Commission will be confronted with a number of choices, vested interests and competing claims. Our approach in this section of our comments is to reference certain principles and balanced alternatives that we believe could govern a rational construct for the Commission devising a better system.

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1.2 Operating Framework

In formulating the principles set out below, we adopted, as an operating framework, an efficient proxy voting system should:

i. Effectively connect issuers with their Owners[1];

ii. Recognize that Owners' voting is a vital governance check on the role of the Board;

iii. Generate accurate results by providing appropriate transparency and verifiability – issuers and Owners have a large stake in the accuracy of the voting outcome;

iv. Be adequate for the challenges given it and not pass over current limitations; and

v. Allocate costs equitably relative to the utility of the system and the expectations of its users.

[1] The term "Owner" is used deliberately throughout these comments to refer to that entity/person that holds the economic interest in the performance of the security, as distinct from another entity or person that may act as a nominee for an Owner or acts in an intermediary capacity on behalf of an Owner, but without any residual risk in the performance of the security or interest in exercising rights pertaining to the security.

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1.3 Guiding Principles

The following principles emerged:

Accountability to Owners – Effective shareholder communication and the exercise of voting rights are fundamental elements of good corporate governance. This is because good corporate governance holds as a key tenet that the Board (as representatives of the Owners) is accountable to those Owners for the delivery of performance information to them, so that Owners can evaluate such information. In turn, by voting on items of company business, Owners provide the Board with a mandate to govern for a further financial year. As such, annual or extraordinary meetings of Owners are the most publicly visible corporate governance event between the Board and the Owners.

Costs – An efficient proxy system should distribute costs fairly and proportionately across all stakeholders involved in the process. The current system shifts heavy costs (network externalities) to issuers for communicating with their Owners without commensurate benefits. These high costs exist because securities intermediaries control access to Owner data, and issuers are "forced" to communicate with their Owners through the monopoly service provider agent of those intermediaries.

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Conflict free – An efficient proxy system should be free from conflict of interest. It should not create or entrench an information monopoly over access to Owner data that creates fee benefits for various intermediaries, yet intermediates issuers from their Owners.

Use of technology – An efficient proxy system should enable direct communication between issuers and their Owners, supported by advances in technology. Technology has advanced dramatically, yet the basic structure of the system has not.

Competition – An efficient proxy system should facilitate competition for services. It should be an open network that allows competitive market players to compete for service delivery.

Timeliness – An efficient proxy system should foster the timely delivery of Owner materials. A system in which each member of the chain only sees its next hierarchical link and no one sees the entire process from start to finish is prone to error and delay.

Transparency – An efficient proxy system should be transparent. Reasons for opacity should be carefully vetted to ensure that the interests of critical constituents (Owners and the listed issuers) are taken into account. The most troubling malady of opacity and complexity in the system, is the system's inability to provide vote verification and end-to-end audit trail.

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Accuracy – Any voting system is only as good as its post-system voting verification. A complex system of holdings and a circuitous system of distributing materials, soliciting proxies and collecting voting instructions creates a serious problem for verification.

1.4 Considerations for a Better System

We understand that there are a number of possible reform steps that the Commission could take, some with greater degrees of materiality than others. Our approach is a top-down positioning of alternatives or accommodations that we believe might assist the Commission in finding solutions for the issues with the current system.

1.4.1 Reform Certain Aspects of the Indirect Holding System

We note the Commission's acknowledgement that the current structure supports prompt and accurate clearance and settlement of securities transactions, yet adds significant complexity to the proxy voting process.[2] While we understand that there are legacy reasons behind the system evolving in the way that it has, we believe that many of the issues raised in the Release can be solved by taking a serious look at reforming certain

[2] The Release on p. 8.

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aspects of the indirect holding system in order to create reliable records for communication with Owners.[3]

We believe that one of the fundamental issues requiring examination is the fact that "Cede & Company" ("Cede") be registered as the holder for all deposited securities cleared and settled by The Depository Trust and clearing Corporation ("DTC") in DTC. We understand the necessity of Cede's presence to clear and settle the enormous volume of transactions; however, it also means that a shareholder's list is eliminated.

In that respect, we draw your attention to approaches taken in other international markets that have sought to more clearly define the role of a Central Securities Depository ("CSD") where securities are traded in a dematerialized environment. Generally, the CSD is the "Operator of a relevant [clearing and settlement] system" that enables "units of security to be evidenced and transferred without a written instrument".[4] In those markets, the entity performing the role of a clearing house or that of an Operator is not a registered holder and has no reason to be so. This is because the legal title to the shares is entered in the name of the "member" that is entitled by the rules of the system to hold and transfer securities and make payments. A "member" parallel in DTC would be a DTC participant that has a securities position in a specific issuer, but would not include

[3] Seminal events include: the "Paper Crunch" of the late 1960s; SEC Study of Unsafe and Unsound Practices of Brokers and Dealers (December 1971); and the Securities Acts Amendments of 1975 imposing "immobilization" and creating the indirect holding system.
[4] See https://www.euroclear.com/site/publishedFile/dom_lgl_frmwrk_0302_tcm87-122898.pdf&action=dload.

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any intermediaries that hold through such DTC participant, i.e. the layer of intermediaries directly below Cede.

Under this type of structure, the "Operator" of the system does not hold any of the underlying securities itself or intermediate in the ownership chain, but simply provides the owners of securities with the ways and means to hold and transfer them securely in electronic form. Under this model, the name of the "member" appears on the register of shareholders and therefore evidences legal title in the securities.[5] The register of shareholders representing those uncertificated securities can be kept by the "Operator" itself in its records or maintained outside the "Operator" by or on behalf of the issuer itself.[6]

What stands out under this type of model is that the transfer of legal title occurs at the point of settlement in the clearing and settlement system, and the system itself creates the register of those "members" that have bought or sold the relevant securities and is always

[5] We are aware that Article 8 of the Uniform Commercial Code ('UCC") governs the transfers of stock in the U.S. and that shares are transferred by registering the transfer on the books of the issuer albeit that the shareholder may not have legal title to the shares. In that respect the position of Cede on the issuer's register is obvious as Cede acts as the enabler from a legal perspective of the devolution of voting rights for holders of securities in DTC in "Street Name".

[6] In the United Kingdom, the Uncertificated Securities Regulations 2001 provide that the name, address and holding of holders of uncertificated shares are recorded in the settlement system and transferred to the issuer. In Germany, Clearstream Banking AG generates sub-accounts of its clearing participants by assigning an alphanumeric code to the entitlements held for specific investors and replicates this data in the data banks of the share registers attached to the settlement system. For further insight, see David C. Donald, "The Rise and Effects of the Indirect Holding System: How Corporate America Ceded its Shareholders to Intermediaries", Institute For Law and Finance, Johann Wolfgang Goethe-Universitat, Frankfurt.de/2007/4885/pdf/ILF WP 068.pdf.

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up-to-date. In the UK, it is off the back of the register of "members" that entitles an issuer to identify its Owners beneath this first layer, using a regulated disclosure process.[7]

We find it somewhat curious that DTC is the first port of call for a securities position listing when, in actuality, the holdings represented by this list might well be quite different from the list generated by intermediaries for their distribution agent to send out proxy voting materials. Further, in the event of a conflict, it would seem that it is the responsibility of the intermediary to reconcile the conflict by a method of their choosing.[8]

We believe that these flow-on problems should best be addressed by looking at the role DTC should play.[9] We believe that DTC should be the primary record-keeper or reconciler of intermediaries' books and records much in the same way as the "Operator" of a clearing and settlement system is required to do in the UK and in many other European markets.

In our view, the symptom of many of the problems of the U.S. proxy system stem from DTC stepping out of the voting process entirely through the issuance of an "omnibus proxy." This triggers a chain of legal authority where intermediaries then deposit powers of attorney with their distribution agent so that the agent can cast a legal proxy on their behalf. Perhaps as a corollary to this attenuation of legal authority, it then appears that

[7] See Section 1.4.4 below.
[8] See our further comments in Section 1.4.2 below.
[9] We note that Diagram 1 on p 15 of the Release has DTC playing no role in the inbound aspect of the proxy voting process.

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practical problems or issues requiring resolution are not dealt with in a consistently transparent manner within the system, and their resolution relies upon the internal operations of intermediaries well away from the purview of the best (DTC) records available in the clearing and settlement system. Having DTC as an active participant in the integrity of the process or moving to a model which makes DTC participants directly below Cede shareholders on the books of the issuer (with appropriate disclosure protocols), as exists in many European markets, might be a top-down approach worth considering.[10]

We are also aware that over the years, U.S. market participants have addressed the concept of a Direct Registration System (DRS), which could provide an alternative to more direct shareholder communication mechanism when contrasted with the highly intermediated shareholder communication directed through the indirect holding system. Our high-level observation of DRS indicates that DRS cannot operate effectively, because brokers control the relationship with the Owners and are in an optimal position to suggest to the Owners the "benefit" of maintaining their DRS shares in the Cede position in DTC. This has the effect of perpetuating the intermediation between issuers and their Owners and entrenching the role of brokers as interposers, but without appearing to attribute any significant value to the Owner communication process.[11] We address this aspect in Section 1.4.2 below.

[10] European markets have found an appropriate legal solution to recognize the transfer of legal title in dematerialized securities in a centralized clearing and settlement system.
[11] Ibid at note 6.

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1.4.2 Maintain the Indirect Holding System but Amend the Shareholder Communication Rules

The rules in the Securities Exchange Act of 1934 (the "Exchange Act") compel issuers to communicate with their Owners through intermediaries. This communication is blind, since the issuer has no access to Owner information and must wait until an appropriate inquiry is made via the layers of intermediaries before communication can begin. Even when this search process is complete, an issuer takes little comfort in the accuracy of a "shareholder" mailing list, since such a list is a combination of unlinked and unverified DTC participant position listings, client account records of banks and brokers, records of investment managers, etc.[12] In addition, the proxy distribution process is undertaken by a service provider with which the issuer has no formal contractual relationship. There are no quality assurance requirements over the timing of distribution, the completeness of distributed materials or the design of the Vote Instruction Form (VIF) sent to Owners.[13]

We believe that the current monopoly over Owner information and the associated monopoly over communication with Owners create significant inefficiencies.

[12] See the Business Roundtable, "Request for Rulemaking Concerning Shareholder Communications", Petition 4-493, April 12, 2004.
[13] The Broadridge Financial Services version of the VIF has space, layout and character limitations that can result in agenda proposal language being abridged: it does not permit issuer customization and is generally not provided to an issuer until after proxy materials have been distributed.

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There are time delays in disseminating materials to Owners, due to the custodial layers requiring inquiry before communication can begin. We note that the various business days "notice and pause" periods in Rule 14 of the Exchange Act only prolong the process further.[14] This can be exacerbated further in the case of non-U.S. issuers where local market legal restrictions often require less than three weeks notice be provided for a meeting.[15]

The complex layer of intermediaries can cause errors in the voting and tabulation process, with votes being lost or difficult to audit.[16] The complexity in undertaking verification exercises that involves multiple parties – tabulation agents, custodians, broker-dealers and Owners – is the byproduct of the complex and circuitous current communication *pathways*.

The transparency of a single verified Owner list creates the possibility of effective vote verification and vote confirmation and addresses many of the issues that underlie overvoting.[17] For this paradigm to succeed, it requires the upfront creation of a list of Owners entitled to vote and a mechanism that monitors changes in ownership during the

[14] See Rule 14a-7 and Rule 14b-1 of the Exchange Act as examples.
[15] This issue has been mitigated for EU issuers due to a harmonization of standards around meeting "notice periods" under the European Shareholder Rights Directive (Directive 2007/36/EC, 2007 O.J. (L 184/17), of the European Parliament and of the Council on the exercise of certain rights of shareholders in listed companies, July 11, 2007). However, other jurisdictions have differing and varied standards with abridged notice periods for meetings.
[16] The past 10 years have been replete with incidents: the Compaq/HP merger; the AXA/MONY merger; the Heinz board election; the CVS Caremark. See also Paul Myners "Review of the impediments to voting UK shares", (2004) http://www.manifest.co.uk/myners/04-02-04%20Final%20SVWG%20Report.pdf
[17] See Marcel Kahan and Edward Rock, "The Hanging Chads of Corporate Voting", Georgetown Law Journal, Vol 96, 2008 http://www.georgetownlawjournal.org/issues/pdf/96-4/kahan-Rock.pdf.

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voting period, so that new Owners have the opportunity to exercise voting rights that correlate with their economic interest.[18] We expect that the need for custodians and brokers to cooperate to compile an accurate Owners' list (and bear the cost) might be met with some resistance, but we consider that the accuracy with respect to this type of information is, objectively, a responsibility that falls within their professional area of responsibility.[19]

1.4.3 The OBO/NOBO issue

We understand that an important aspect of Owner communication is the issue of the OBO/NOBO distinction. We appreciate that certain parties involved in the process might advocate preserving the distinction. However, we believe that the need to preserve the distinction as it currently stands is unnecessary, and the oft-stated philosophical rationale for it is overstated. In addition, we believe the largely unevaluated benefits of preserving the distinction are dwarfed by the governance cost of not addressing this issue squarely.

A primary anomaly of the current OBO/NBO distinction is that even where an issuer procures a NOBO list, proxy voting materials must still be distributed indirectly through intermediaries. Within this framework, an issuer pays both the costs of procuring the

[18] See our comments on Dual Record Dates in Section 2.3.2.
[19] The possible "data aggregator" entity raised by the SEC in the Release might well fulfill this function. Conceivably, this entity could be the current largest proxy agent of the banks and brokers or another market participant wishing to offer these services. As noted in the comments under Section 1.4.1, the source of such data should be the "best" source and not a compilation of disparate records as is currently the case.

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NOBO list and the distribution costs through intermediaries – in effect paying intermediaries for the *right* to communicate with NOBOs.[20] As a matter of principle, good governance practice should create opportunities for Owner engagement, not preserve barriers that entrench a free flow of dialogue and information exchange. In recent years, the changing nature of the governance and regulatory landscape exhibits strong preferences for issuers and Owners to engage more, not less, on a variety of issues.[21] We would therefore not support a continuation of the OBO/NOBO distinction.

However, if the OBO/NOBO distinction is to be preserved, at the very least, reform should focus on having NOBO information available automatically to issuers, at no cost, and on permitting direct communication, if desired by issuers.

We also note that various recent SEC rule-making initiatives have addressed enhancing communications with, and among, shareholders using electronic means.[22] However, those rules still require that the notice advising that proxy materials are available electronically must be sent physically, and indirectly, through intermediaries.[23] In the Release, the Commission discusses recent trends in retail voting participation and

[20] We use the term *right* carefully. The holder of a right is protected against the interference or uncooperativeness of one or more other people. The people against whom the right lies are under a duty to comply with its terms, whether the terms call for non-interference or assistance. See Wesley N Hohfeld 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' (Yale University Press, New Haven, 1919).
[21] Executive remuneration; director elections, bylaw amendments, major transactions, etc.
[22] *Internet Availability of Proxy Materials*, Exchange Act release No. 34-23847.
[23] Broadridge Financial Solutions sets its own fees for "Notice and Access" as the sole provider of this service, which must take place through its intermediary clients. These fees are in addition to relevant NYSE fees that may apply. See http://www.broadridge.com/notice-and-access/basic.asp.

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expresses some concern about retail participation. We believe communication with retail NOBOs, and in fact all Owners, can be achieved at low cost through direct electronic communication.

1.4.4 Approaches in Other Markets

We would also encourage the Commission to draw upon the approaches taken by regulators in other markets regarding Owner identification and communication. Most EU markets have, or are trending towards, a mandatory disclosure regime where there is a regulated process by which issuers or their agents can obtain disclosure of underlying Owners beyond the first nominee layer of the CSD.[24] Conceptually, the registration of changes in ownership is linked with the settlement process. In the UK, obligations for the segregation of assets at the level of the CSD (EuroClear UK and Ireland) allow the CSD to provide information on its clients' holdings to the transfer agent that maintains a mirror copy of the register (the official register being in the books of the CSD), as noted above.[25]

The names or entities that appear on the register may themselves be Owners (if they choose to hold shares in their own name) or custodian banks or nominee companies,

[24] See section 793 of the UK Companies Act 2006. In France, Article L 228-2 of the Code du Commerce provides for a method of getting a clear and detailed picture of the shareholder base through the central depository ("dépositaire central"), currently Euroclear.
[25] See section 1.4.1.

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holding the securities on behalf of an Owner. UK issuers have the right under Section 793 to require holders of the shares either to confirm they themselves are the Owners or to identify the Owners if they are another person or entity. Because of this combination of Section 793 and the real-time updating of the legal ownership information, UK issuers can track changes in the composition of their end-investors with a considerable degree of confidence.

The European Central Bank ("ECB") is also currently exploring the importance of shareholder identification pursuant to the Target2-Securities initiative.[26] The ECB has rightly recognized that the desire for a single European settlement system is linked to the capability to be able to provide post-settlement services – servicing the holder of the asset (read "equity" for this purpose) with the rights that need to be exercised as a consequence of holding that asset. This includes corporate governance rights that need to be exercised cross-border (e.g., voting) via the CSD network. Much of the focus in this area is on harmonizing rules for more effective identification and direct communication with Owners, by using the technology and communication pathways of the clearing and settlement system. In many respects, we see the issues being confronted in Europe have a parallel with the issues raised and referenced by the Commission in the Release – the indirect holding system and the consequences for Owner identification and communication, regulation to strengthen an issuer's rights in this area, and benefits to

[26] The fundamental objective of the T2S project is to integrate and harmonize the currently highly-fragmented securities settlement infrastructure in Europe. It will reduce the costs of cross-border securities settlement within the euro area and participating non-euro countries and increase competition and choice among providers of post-trading services.

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Owners for being able to exercise governance rights more effectively in the companies in which they hold an economic stake.

We believe the U.S. system should be viewed in an international context, recognizing there is a very large volume of non-U.S. investors invested in U.S. companies and U.S. investors invested in non-U.S. companies. This invariably means that identifying and communicating with Owners has international corporate governance implications and ultimately impacts the way the U.S. market is viewed from a governance perspective.

We would also note that the obvious ostensible competing interests of Owner privacy and Owner identification have been discussed within the context of transparency principles and on the basis that the presence of asymmetric information has cost implications.[27] From a UK perspective, market participants appear comfortable with the Section 793 process, and we believe that appropriate regulatory controls can protect this type of Owner information from misuse.

We believe that the current U.S. system imposes significant costs for shareholder identification that yield little results. Identification must be based upon historical 13F filings (with relatively high ownership disclosure levels), and proxy solicitation firms are hired to try to connect holdings to custodial accounts. The fact that the majority of U.S. holders are OBOs makes identification more problematic. The result is often the outlay

[27] http://ec.europa.eu/internal_market/securities/docs/transparency/directive/sec-2010_611_en.pdf.

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of significant expense to shareholder identification and proxy solicitation firms without a commensurate benefit. When the shareholder distribution cost is factored in, the overall cost to an issuer is significant and disproportionate relative to others, and the identification information garnered is largely ineffectual.

1.4.5 Maintain the Indirect Holding System but Reform the Fee Structure

1.4.5.1 Fees Regulated by FINRA

Currently, proxy distribution fees are regulated by the Commission pursuant to NYSE (the "Exchange") rules with the current reimbursement rates approved in 2002. We would point out that at that time, the role of the Exchange was quite different from what it is today. As a broker-dealer-owned mutual organization, the Exchange relied on its members for capital contributions and was, in turn, able to provide required services to them. In this context, the interests of the Exchange and its members were closely aligned in terms of continued viability and success. The main function of the Exchange, representing a collective group of "intermediaries", was to provide market facilities for the sale and purchase of securities. Although not-for-profit, the Exchange was (and still is) a business focused on market share, sourcing revenues and controlling expenses. And

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within this construct, broker-dealers acted in each of the capacities of customers, owners and managers of the Exchange.[28]

With the Exchange going public in 2005, the former alignment of the Exchange and its broker-dealer members changed irrevocably from both an economic and governance perspective. Yet within this new paradigm, the proxy distribution fees charged to issuers continue to be regulated based upon the 2002 landscape, as if the governance model had remained unchanged. We believe that the Commission should consider the current regulated fee structure for proxy distribution, taking these market changes into account, and suggest that FINRA, as independent regulator, should be the appropriate body to examine the appropriateness of the current level of proxy distribution fees.

1.4.5.2 Fees Set by the Market

We believe the current market structure, together with the regulation of fees, has resulted in proxy distribution fees being higher than they should be and the economics of the current network for proxy distribution lack transparency and discourage competition.

In the fundamental sense, proxy distribution is an information and communication network like many others in existence in the financial markets. As such, we believe this network should deliver outcomes and align the interests of the primary users of the

[28] See Andreas M Fleckner, "Stock Exchanges at the Crossroads", Fordham Law Review, Vol. 74, pp. 2541-2620, 2006. Available at SSRN: http://ssrn.com/abstract=836464.

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network – issuers and their Owners – for the network to be considered efficient. This would mean evaluating the benefits the network should deliver. We consider that these benefits would include some or all of innovative technology, optimal use of technology, user choice, quality control/assurance, value for cost, accuracy and reliability, and transparency.

The structure of the current network is an artificial monopoly. Due to the current rules for shareholder communication, all proxy materials must be distributed via intermediaries. Control over the key information source (Owner identification) means that intermediaries or their agent(s) control the hierarchical network. Hierarchies by their nature impose greater costs because information and communication needs to be cascaded up and down in the hierarchy. We would also point out that the ability to influence the network requires a position at the top of the hierarchy. As such, the top of the hierarchy controls the speed, quality, clarity and accuracy with which the information is made available and the level of investment in the technology that supports the service. We believe this ought to represent a policy concern, because the primary users of the network have no control, purchasing power or choice over any aspect of the hierarchy. In terms of the costs charged by the hierarchy to provide the services, we believe that the costs are based upon the private valuations of those services and on what the hierarchy

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can privately appropriate. It is unlikely that the hierarchy considers the value of the services for any user outside the hierarchy.[29]

We believe with the combination of Internet technology and a network that does not discriminate based on the choice of service provider for communication, there is an opportunity to lower transaction costs and create a more efficient market for proxy distribution. We would support a network that permits alternatives, incents competition and allocates costs more efficiently.

We also believe there is some degree of merit in the Commission's recognition of a "data aggregator" or other repository where a user can access required information for an appropriate fee and use that information for communication purposes. We understand there will be a need to have control over the information, but would not endorse an outcome that restricts either access to or use of information, unless it was for an improper purpose.

[29] For a fuller understanding of the impact of networks see Nicholas Economides, "The Economics of Networks", International Journal of Industrial Organization, Vol.14, No. 2 (March 1996) and Christiaan Hogendorn, "Spillovers and Network Neutrality", (2010) http://openinternetcoalition.com/final_Hogendorn_0108.pdf.

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2 Specific Comments

We set out below comments on specific areas of the Release, adopting the Commission's headings. Many of our comments flow from the principles identified and articulated above. We have not commented on all areas, as we believe many issues might be more suitably addressed by industry experts.

2.1 Accuracy, Transparency, and Efficiency of the Voting Process

2.1.1 Over-Voting and Under-Voting

We believe much of the over-voting problem can be resolved by better tracking of securities-lending transactions through enhancement of the clearing and settlement system in order to create an electronic record that properly records and accounts for changes in ownership on a real-time basis. As an alternative, we would support a proposition that requires banks and broker-dealers to generate an integrated and properly vetted list of Owners that reconciles those that have voting rights *prior* to any proxy distribution. There is an overwhelming need for standardization and consistency in this area, which would have associated benefits for audit and vote confirmation processes.

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We would also point out that the profitability currently derived from share lending by intermediaries might warrant their incurring costs for the correct compilation of ownership records.

2.1.2 Vote Confirmation

The litmus test for the robustness of any voting system is the ability to confirm the receipt of a vote and the correct number of shares represented by that vote. The layers of intermediaries involved in both vote lodgment and any vote confirmation process create delay and add cost and complexity. This is especially true where there are questionable practices in the areas of shareholder records and tabulation methodologies. There appears to be no sound conceptual reason to us that vote confirmation could not take place electronically, if the system could provide assurance as to the veracity of the information.

Vote confirmation will have to be paid for, and involving intermediaries in the process will likely add cost. We believe issuers would be most reluctant to bear this cost given the current cost burden they face under the current proxy system – the fact of paying to distribute proxy materials to Owners without identification rights would be made highly unpalatable if issuers were asked to bear costs attached to vote confirmation.

In terms of some of the other mechanics, we believe that if the OBO/NOBO distinction is preserved, then both OBOs and NOBOs should have the ability to receive vote

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confirmation in any case. However, it is our view that an OBO should bear the additional cost of any anonymity safeguard(s) that might need to be applied for vote confirmation purposes.

2.1.3 Proxy Voting by Institutional Securities Lenders

We believe that the Commission's observations on vote disclosure by management investment companies relates to the concept of vote confirmation. If investment companies are required to disclose the number of shares voted, it might be a useful way to begin to audit whether any vote confirmation provided by an issuer is a "match". However, the benefit is only notional, given that funds vote through custodians (sometimes multiple custodians). In this sense, custodians will only be able to confirm their total vote lodged with the issuer without an issuer being able to confirm that a specific fund's vote was a portion of the total voted lodged by the custodian. As noted above, we believe a useful and robust vote confirmation system works best where Owners are identified. Perhaps a useful *quid pro quo* would be to make vote confirmation available only where an Owner identifies itself to an issuer. An issuer might well consider bearing some of the cost of vote confirmation under that circumstance.

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2.1.4 Proxy Distribution Fees

As noted earlier, we believe the entire fee structure for proxy distribution needs objective examination anew. At the heart of this examination must be the role that intermediaries currently play in the process and whether, in light of advances in technology and the governance imperative for better connectivity between issuers and their Owners, the current process fairly apportions costs and benefits in serving the interests of the primary users of the system.

We believe the current fee model has a number of anomalies that warrant impartial analysis.

First, the level of regulated fees was last examined in 2002. Much has happened since 2002 in terms of technological advances, technology take-up by investors, regulation around electronic communication, and structural changes to the NYSE. We believe the demutualization of the NYSE, without a recent consideration of what this might mean for the primary beneficiaries of a regulated fee structure, has allowed the natural monopoly to continue to perpetuate. We also believe it is no longer appropriate to continue to use paper distribution as the comparator when justifying cost savings for eliminating paper mailings using electronic media. It is our view that the use of electronic media for communication purposes should be viewed as sufficiently mainstream for it to be

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accepted as a standard method for communication in 2010. We expound on this rationale further below.

Second, at the heart of the regulated fee structure is the regulatory requirement for intermediaries to be reasonably reimbursed for their proxy distribution costs. This entitles intermediaries (or their agents) to charge a "Processing Fee" of up to $ .40, which, for all intents and purposes is a handling fee. We believe the original basis for the fee was the coordination cost in procuring Owner records from intermediaries and setting up the proxy job, mail sorting and distributing proxy materials, etc. At the time, the majority of Owner communication was heavily paper-based, requiring a large mail-house, activities heavily manual in nature, and procuring paper records and other manual processes to generate and, as necessary, scrub Owner mail files. In the data attached, we have identified the average "Processing Fee" expense accounts for 49.09% of the total job expense, even though the number of pieces mailed represents only 30.09% of the total number of accounts serviced.[30] It is our view the bulk of any "Processing Fee" should correlate closely with the process or logistics involved in preparing and mailing physical materials, but there should be a different and less significant fee component for a mailing that is eliminated, because such accounts do not have to be processed or handled in the same way. Such an approach would look to properly and accurately differentiate concerning the true processing costs involved for what are *different* communication processes.

[30] See lines 26 and 27 of Excel file

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Third, we believe the fee basis for 'Eliminating Mailings" warrants examination. The idea that intermediaries (or their agents) are entitled to charge mail elimination or suppression fees was originally predicated on the rationale that eliminating mailings reduces mailing costs. We understand certain process changes may have been implemented at that time (or even prior) to defray costs for implementing a mail elimination process when this fee was approved. However, we do not believe this should have the effect of creating an annuity revenue stream for intermediaries (or their agents). We believe it was fair and reasonable to charge a mail elimination fee to defray costs for implementing a new process or a one-time mail elimination fee for a new account that eliminates a mailing. However, we do not think this fee should be charged in perpetuity nor should it apply when electronic delivery has been selected as the preferred delivery method or where a mailing is suppressed for each account beyond the primary account suppressed under the current "Householding" rules. We consider it incumbent upon intermediaries (or their agents) to maintain accurate records of Owners that flag an account to eliminate a mailing and that this record should be properly maintained for all future mailings on that account. The attached data identifies that, on average, mail elimination fees account for 22.35% of the total distribution expense.[31] In an era where electronic communication is both heavily encouraged and significantly utilized, we do not think it is appropriate that fees for eliminating a mailing should constitute this level of charge relative to the total job expense. The notion that the level

[31] See line 29 of Excel file.

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of fee can be justified based on what the charge would have been for a physical mailing is, we believe, an increasingly tenuous position. It is also inconsistent with the progressive rulemaking initiatives of the Commission to encourage the use of technology.[32]

We believe an impartial party should examine the proper cost basis (if any) for eliminating a mailing. Projections and analysis should properly include an assessment of fee structures in a competitive market to provide these services and a gross margin analysis to ascertain a reasonable benchmark.

Fourth, we believe a thorough examination of the continued billing of a "Processing Fee" for separately managed accounts ("SMAs") is urgently required. As was put forth by the Securities Transfer Association, Inc. ("STA") in its recent letter to the Commission[33], wrap accounts and SMAs are essentially the same in that in each case, day-to-day management is delegated to a sole advisor, and as such, one set of proxy material covers all the underlying accounts. For this reason, wrap accounts are quite rightly exempt from a "Processing Fee", but inexplicably, SMAs are not. The ramifications of this oversight

[32] Examples include concepts such as "Access Equals Delivery" for prospectus delivery requirements; "Notice and Access" for the Internet Availability of Proxy Voting Materials; and the NYSE elimination of the need to deliver physical Annual Reports.
[33] Letter to the Securities and Exchange Commission from the Securities Transfer Association, Inc. on Proxy Communication Fees, June 2, 2010; see http://www.sec.gov/comments/s7-14-10/s71410-2.pdf

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are great expense to the issuer, as our data indicates that on average, the processing fee accounts for SMAs accounts for 17.00% of the total distribution bill.[34]

Furthermore, we note from an analysis of bills we receive for proxy distribution, there is a line item notation for "Postage Savings". It is our understanding this savings represents a discount from the U.S. Postal Service ("USPS") for the intermediaries' agent conducting a "presorting" service in advance of the mailing. This rebate is then shared equally by the issuer and the intermediaries' agent for performing the service. We would question the appropriateness of the intermediaries' agent in collecting this fee[35], given that the intermediaries' agent already collects a fee for physical mailing under the terms of the "Processing Fee".[36] It is our position that coordinating the mailing at the best possible rate should be inclusive of the "Processing Fee". Any expense the intermediaries' agent absorbs in performing the presorting function can be billed as a separate item. At present, the rebate given to the intermediaries' agent by USPS constitutes a sizable portion of the cost to the issuer, as this fee accounts for 13.83% of the physical mailing cost and 3.24% of the total distribution expense.[37]

Closing the discussion of proxy distribution fees, we believe it is time for intermediaries' agents to acknowledge and reflect in their pricing the new realities of an electronic world.

[34] See line 31 of Excel file.
[35] We are aware that NYSE rules permit apportionment of "savings" in this way.
[36] We understand that this is defined in the invoices rendered by the intermediaries' agent as "...relat[ing] to efforts to obtain all beneficial shareowner records, receive materials to be mailed, coordinate timing and *method of mailing/delivery* of such materials, *mail material*…" (emphasis added).
[37] See line 32 and 33 of the Excel file.

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The well-worn and, we would contend, passé reliance on equating, measuring, and justifying fees based on savings compared to physical mailing is no longer appropriate. The paper-based proxy communication system is largely redundant. Given that electronic distribution currently outpaces physical delivery by more than 2 to 1, this pricing model requires an extensive revision. In an electronic world, proxy materials should be delivered electronically rather than by physical copy.

Where issuers are required to pay distribution fees, we believe in the freedom to select a provider, have a direct relationship with that provider, negotiate their fees and have the ability to verify that the distribution has been carried out accurately and in a timely manner. Such an approach would require increased access to Owner records or new protocols for a "data aggregator", as referenced above.

In any event, we contend that an independent audit of the regulated fee structure should take place to evaluate their current appropriateness.

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2.2 Communications and Shareholder Participation

2.2.1 Issuer Communications with Shareholders

We believe we have provided in-depth commentary of our views and a range of alternatives under the General Comments section of our letter. In our view, the issues outlined by the Commission in this section of the Release underpin many of the anomalies encountered with the current proxy voting system. Access to Owner information is the critical component for creating a robust, verifiable, cost efficient and auditable proxy voting system. We have framed a number of thoughts and alternatives around how more effective Owner communication can be achieved. In our opinion, neglecting to address this issue for what it actually is would be a lost opportunity for the material users of the current proxy voting system, who ought to be better and more efficiently connected if both the governance and cost concerns of the current proxy voting system are to be overcome.

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2.3 Relationship between Voting Power and Economic Interest

2.3.1 Proxy Advisory Firms

We believe proxy advisory firms provide a form of governance oversight that is valuable to relevant market participants. We understand the concern that conflicts of interest may exist and that there may be issues with the methodology for formulating voting recommendations. We would favor the regulation of proxy advisory firms. The primary role of proxy advisory firms is as agent of Owners, and we believe it is inappropriate that proxy advisory firms also act for issuers, as it represents a potential conflict of interest.

We have also witnessed noticeable differences in the way in which proxy advisory firms are prepared to engage with issuers on governance matters. This can stem from different circumstances. A number of U.S. investors have declined to engage with an issuer and defer a discussion to their proxy advisory firm. The proxy advisory firm might then decline to engage or indicate a fee for doing so. Although we do not believe this is a widespread practice, we believe some of the less responsible practices could be addressed if proxy advisors were prevented from acting for both issuers and investors. We would also be interested in regulation that addresses the ability of issuers to comment on any inaccuracies of the reports of proxy advisory firms prior to their publication.

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Finally, in recent times, a number of issuers have been approached by proxy advisory firms offering to sell shareholder voting information prior to the cut-off date for voting. We do not endorse this type of practice.

2.3.2 Dual Record Dates

We are concerned that the voting date is typically set so far ahead of the meeting date – sometimes up to two months. The Owners may change a great deal over this period of time resulting in a disconnect between those entitled to vote and those who have an economic interest in the shares at the time of the meeting.

We suggest the record date be set far closer to the date of the meeting. (In the UK, this is 48 hours, although changes to the register can also be handled up to 6 p.m. the night before the meeting). Proxy materials could still be sent to Owners on the mailing dates some weeks before, but brokers handling purchases and sales in this period should be required to pass the proxy materials onto new Owners when the title to the shares transfers.

There should be no need to have to transfer physical documents, as shares could be sold with voting rights, and there could be a link to the issuer website where the documents may be viewed. This should also reduce some of the problems with over or under voting.

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It would mean that brokers would be required to keep detailed records of who buy and sell shares during the period, and link the voting rights with ownership. We would also refer to our discussion earlier where we addressed possible modifications to the indirect holding system in order to generate more accurate and instantaneously available ownership records.[38]

We note the suggestion in the Release that there should be dual record dates, but find it difficult to understand how this might work under the current framework, given the preexisting issues with accurate Owner data. A possible solution may be to consider the pre mailing date record date as a "soft record date" with the "hard record date" closer to the meeting.

With respect to the concept of permitting beneficial shareholders to submit voting instructions, in advance of receipt of voting materials from the issuer, we do not believe this would promote good governance and informed voting by Owners. Issuers would not wish to receive uninformed or unintended votes from Owners simply to increase voting "participation", and we see little benefits for Owners otherwise.

[38] See Sections 1.4.1 and 1.4.4.

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2.3.3 "Empty Voting" and Related "Decoupling" Issues

We believe that fundamental to the one-share-one-vote principle is that economic interest is linked to voting rights. We believe the decoupling of voting rights from the economic interest can have serious implications for the operation of the market for corporate control in many instances. Certainly, what is required is better disclosure of the variety of instances where voting rights are decoupled from economic interests.[39] In terms of how voting rights might be affected upon disclosure, we believe issuers and investors need to engage on the value of voting and the responsible discharge of voting rights.

2.3.4 Concluding Remarks

The Release seeks comprehensive comment on the array of issues affecting the U.S. proxy system. In formulating our response, we believe two overarching themes pervade.

First, granting flexibility to issuers and their Owners to utilize technology to its fullest offers a range of alternatives that can produce positive outcomes for the shareholder communication process. We believe utilizing technology optimally necessitates a policy approach from the Commission that recognizes that the access to, and use of, technology should meet the strategic needs of issuers and their Owners.

[39] The UK Takeover Panel has recently examined similar issues. See http://www.thetakeoverpanel.org.uk/.

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Second, we believe that any reforms impacting the market-oriented system for corporate governance in the U.S. should be examined in the light of relevant regulatory developments occurring elsewhere. A number of international regulators have focused on transparency principles in formulating regulatory policy that seeks to better connect issuers with their Owners. Those regulators have recognized that complex securities holding systems require a disclosure mechanism that enables all Owners to be identified so that effective communication can occur. The imposition of mandatory disclosure of Owner information has been accepted as necessary to deliver on the imperative for Owners to exercise governance rights, and for issuers to have an identification mechanism to be able to ascertain, periodically, Owners' preferences and their expectations about the way in which their capital is being managed. We would encourage the Commission to explore some of the approaches taken by international regulators in this area.

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We would be happy to respond to any questions that the Commission or its staff may have or to provide any further information available to us that the Commission or it staff feels may be useful to it in connection with the release. For those purposes, please feel free to contact Verdun Edgtton, Vice President and Corporate Governance Officer, phone. +1 (212) 815 3882, email. verdun.edgtton@bnymellon.com.

Respectfully yours,

BNY Mellon, Depositary Receipts

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