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April 14, 2016

Brent Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

VIA ELECTRONIC MAIL
rule-comments@sec.gov

Subject: Transfer Agent Regulations, SEC File No. S7-27-15

Dear Mr. Fields:

The Shareholder Communications Coalition ("Coalition"), appreciates the opportunity to comment on the Advance Notice of Proposed Rulemaking and Concept Release on Transfer Agent Regulations, issued by the Securities and Exchange Commission ("SEC") on December 22, 2015.[1]

This letter focuses on Questions 99 and 100, requesting comment on whether the SEC should require broker-dealers, banks, and other financial intermediaries to "pass through" to transfer agents for public companies certain information about shareholders holding their securities in street name. The SEC is also requesting comment regarding any limitations that should be placed on the use of this information by transfer agents.

Summary Explanation of the U.S. Proxy System

Approximately 25% of the outstanding shares of the typical public company are registered directly with the company and its transfer agent. As the SEC is well aware, the remaining shares of a public company—approximately 75% of outstanding shares—are held in "street" or nominee name, meaning that the underlying shareholders—called beneficial owners—are not the shareholders of record.[2]

Under the street name system, legal title and ownership of individual shares reside with a depository institution. In the United States, this function is performed largely by the Depository Trust Company ("DTC"), a back-office utility operated by the broker-dealer and banking industries.[3]

[1] Transfer Agent Regulations, 80 Fed. Reg. 81,948 (Dec. 31, 2015) (hereinafter "Transfer Agent Regulations").
[2] The term "street name" is short for "Wall Street name."
[3] The street name system was established to improve the efficiency of securities trading by eliminating the need to transfer paper stock certificates. Under this system, stock certificates are immobilized and stored in a central

When a public company seeks to hold a shareholder meeting, a record date is established to identify the current registered and beneficial owners who are eligible to vote at such meeting. For registered owners, the company's transfer agent provides a copy of the proxy materials and a proxy voting card to each of them, either through the mail or electronically.

The proxy communications and voting process is much more cumbersome for a public company trying to reach its beneficial owners (*i.e.*, those holding in street name) about a shareholder meeting.[4] The company first must notify DTC, as the record holder for most of the U.S. corporate shares held in street name. DTC then provides a list of the broker-dealers, banks, and other financial intermediaries holding the company's shares and issues an "omnibus proxy" to these institutions, granting them the authority to vote proxies at the upcoming shareholder meeting. Companies are then required to request information from these financial institutions regarding the number of proxy packets that need to be provided to them for distribution to beneficial owners.[5]

Under SEC and stock exchange rules, broker-dealers, banks, and other financial intermediaries are responsible for handling proxy processing and communications activities involving their customers, including the delivery of proxy materials with information about the matters to be voted on at a shareholder meeting. Individual public companies pay for these services based on a fixed price schedule developed and approved by the stock exchanges. Companies are not able to choose among several proxy service providers and do not have the ability to negotiate fees in a competitive marketplace for proxy services.[6]

The overwhelming majority of broker-dealers and banks have contracted out their proxy processing and shareholder communications responsibilities to a single service provider, Broadridge Financial Solutions, Inc. Pursuant to written agreements, broker-dealers and banks provide this service provider with contact information and share positions for their beneficial owners, along with a power of attorney to act as their agent in voting the shares for which they have been granted proxy authority. The service provider then distributes proxy materials through the mail or electronically to all of the beneficial owners of company shares.

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depository created for this purpose. Stock transfers are then handled through an electronic book-entry process, which records transfers among broker-dealers, banks, and other financial intermediaries. More information about this process can be obtained at www.dtcc.com.

[4] The SEC acknowledges this point in the Release. *See Transfer Agent Regulations* at 81,990, note 437 ("There are of course other issues raised by the increasing prevalence of bank and broker recordkeeping for beneficial owners, including complexity in the proxy distribution and voting systems and barriers to communication between securityholders and issuers.").

[5] A similar process is followed for those beneficial owners receiving proxy materials in electronic form.

[6] In New York Stock Exchange rulemakings in 1997, 1999, and 2002, the SEC expressed an interest in market-based alternatives to the current system of exchange-regulated fees for beneficial owner proxy services. *See* Letter from Niels Holch, Executive Director, Shareholder Communications Coalition, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, at 8-11, October 20, 2010, *available at* http://www.shareholdercoalition.com/sites/default/files/SCC%20Comment%20Letter%20to%20SEC%20Re%20Concept%20Release%2010-20-2010.pdf. The SEC also issued a wide-ranging Concept Release on the U.S. Proxy System in 2010, exploring various alternatives to its current proxy rules. Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982 (July 22, 2010) (hereinafter "SEC Proxy Reform Concept Release").

For beneficial owners, the proxy materials they receive do not include the same proxy voting card that registered owners receive from a transfer agent. Instead, beneficial owners in street name receive a Voting Instruction Form ("VIF") to indicate their voting preferences. The use of a VIF is necessary because broker-dealers and banks typically retain the authority to cast the actual votes and do not transfer their proxy authority to the beneficial owners.[7]

The use of a proxy card for voting by registered shareholders and the use of a VIF by beneficial owners creates a bifurcated shareholder voting process that can result in inaccurate vote totals. The current voting process also lacks transparency, and a final vote count is not currently capable of being audited or verified by a third-party, especially in a close contest or dispute.

The NOBO/OBO Classification System

Under current SEC rules, broker-dealers and banks classify beneficial owners holding their shares in street name into one of two categories: (1) Non-Objecting Beneficial Owners ("NOBOs"), or (2) Objecting Beneficial Owners ("OBOs"). A NOBO investor does not object to being contacted by any of the public companies in which he or she invests; however, a company is only allowed to communicate directly with shareholders classified as NOBOs in a very limited fashion and only on non-proxy matters. An OBO investor by definition (but perhaps not in reality) objects to receiving any communications from the companies in which he or she invests. The NOBO/OBO classification is typically handled at the time when a beneficial owner opens his or her account with a broker-dealer, bank, or other financial intermediary.

The NOBO/OBO classification system was established by the SEC in 1983, as part of a shareholder communications framework recommended by the 1982 SEC Advisory Committee on Shareholder Communications.[8] Under this framework, public companies can send general corporate communications directly to NOBOs, such as an annual report or an earnings release. However, a list of NOBOs may not be used by a company to distribute proxy materials; and the names of OBOs may not be disclosed to a company for any purpose whatsoever.[9]

There are no standards or regulatory requirements for how a broker-dealer or bank reviews this classification with its customers at account opening, or on a periodic basis to ascertain if a customer's preferences have changed. The NOBO/OBO classification is also not

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[7] When a broker-dealer or bank retains the legal authority to vote at a shareholder meeting, a beneficial owner who attends such a meeting is not able to vote his or her shares using a VIF. Instead, current rules require a beneficial owner to make special arrangements before the meeting to obtain a legal proxy to vote his or her shares. The use of a VIF at a shareholder meeting does not entitle a beneficial owner to vote in person at the meeting without a legal proxy. This is a very cumbersome process for individual investors who want to attend a shareholder meeting and vote in person, instead of by proxy.

[8] *See* Alan L. Beller and Janet L. Fisher, *The OBO/NOBO Distinction in Beneficial Ownership: Implications for Shareholder Communications and Voting,* February 2010, at 9, *available at* https://www.sec.gov/comments/s7-14-10/s71410-22.pdf.

[9] *See* Facilitating Shareholder Communications Provisions, 48 Fed. Reg. 35,082 (Aug. 3, 1983).

established on a company-by-company basis, and many investors—especially individual investors—do not even know how they have been categorized.

The NOBO/OBO system impedes communications between shareholders and public companies and also creates barriers to communications among shareholders themselves. NOBOs also represent only a portion of a company's shareholder base.

This overly complex system compels a company seeking to communicate with its beneficial owners to use a circuitous process involving numerous financial intermediaries, instead of using a more modernized regulatory framework that is consistent with direct and robust communications between public companies and all of their shareholders, as is now encouraged, if not practically mandated, by investors and regulators alike.

The Need to Eliminate the NOBO/OBO System

In Question 99 of its Release on Transfer Agent Regulations, the SEC acknowledges that increased obligations under federal law have made it more important for public companies and other issuers to "ascertain their securityholders' identities."[10] The SEC then requests comments about whether to address this transparency problem in the street name system by requiring broker-dealers, banks, and other financial intermediaries to "provide or 'pass through' securityholder information to transfer agents."[11]

The Coalition agrees with this proposed reform. However, any information-sharing between financial intermediaries and public companies (and/or their transfer agents) can only occur after the SEC eliminates its regulatory requirement that beneficial owners be classified as NOBOs or OBOs for purposes of shareholder-company communications.

As described earlier, the NOBO/OBO classification system has clearly outlived its usefulness. There is no evidence that beneficial owners who are long-term investors require anonymity regarding the companies in which they invest. And, in an age of Internet connectivity, improved communications technologies, and heightened corporate governance standards, there is no reason to have this type of barrier to open communications between a public company and its beneficial owners.

The specific reasons in favor of eliminating this classification system are many:

- The NOBO/OBO system prevents public companies from knowing the identities of their beneficial owners and communicating with them;
- Individual investors do not understand the NOBO/OBO system and do not generally have an expectation of anonymity regarding the companies they invest in regarding corporate governance matters;

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[10] *Transfer Agent Regulations* at 81,990.
[11] *Id.*

- Research on shareholder communication preferences indicates that a substantial majority of individual investors prefer NOBO status, especially if there is a cost to maintain anonymity from a public company;

- Companies are not using the NOBO list for shareholder communications, as it cannot be used for proxy distribution purposes, and current SEC rules do not permit a company to have one process to communicate uniformly with all of its investors;

- Any type of communications with beneficial owners must be through an expensive and circuitous system that creates disincentives for direct communications, when the opposite should be the case; and

- There is a lack of consistency among broker-dealers and banks regarding how beneficial owners are classified as NOBOs or OBOs, with no standards or regulatory requirements for how a broker-dealer or bank reviews this classification with its customers at account opening or on a periodic basis (*e.g.*, to re-visit a classification decision).

Public companies have sought changes to the NOBO/OBO system for many years.[12] These reforms would substantially improve shareholder communications and would bring the U.S. system in line with the capital market practices of other countries, which are generally more transparent regarding the identities of beneficial owners.[13]

The Importance of Protecting Investor Privacy

In Question 100 of the Release, the SEC asks whether there should be any limitations on the use of beneficial owner information that is "passed through" from broker-dealers, banks, and other financial intermediaries to transfer agents, as issuer representatives.[14]

The Coalition supports at least three limitations, or constraints, on the use of this beneficial owner information by a public company.

First, any communications between a company and its beneficial owners should only be for purposes involving the corporate or business affairs of that company.

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[12] *See, e.g., SEC Proxy Reform Concept Release* at 42,998-43,002.

[13] For example, in the United Kingdom, a public company has the right to learn the identity of individuals and institutions with voting rights and/or beneficial owner interests in its shares. The law imposes both civil and criminal penalties for a failure by a financial intermediary to provide information about beneficial owners, after a request for such information has been made. *See* Sections 793-795 of the UK Companies Act 2006. In Australia, a public company is required to keep a register with the name and address of all its shareholders, including beneficial owners. *See* Section 169 of the Commonwealth of Australia Corporations Act 2001.

[14] *Transfer Agent Regulations* at 81,990.

Second, the Coalition believes that investors should be able to affirmatively choose to remain anonymous from the companies they are investing in as owners. The Coalition is very mindful of the fact that some investors—both individual and institutional—may want to retain their anonymity, either for trading purposes or for proxy voting purposes, or both. To address this concern about investor privacy, the Coalition has recommended that individual or institutional investors who wish to remain anonymous should be permitted to register their shares in nominee name, or hold their shares in a custodial arrangement.

Nominee status and custodial arrangements are common methods for institutional investors to hold their shares and these methods would not change under the Coalition's proposal. The Coalition's proposal would merely make available to individual investors the same methods for holding shares that are currently available to institutional investors, in lieu of an OBO classification. The Coalition also advocates that the cost of registering shares in nominee status (or holding shares in a custodial arrangement) for individual investors should not be borne—directly or indirectly—by those investors.

Third, and as an additional investor protection measure, the Coalition believes that SEC privacy regulations should apply to any public company use of beneficial owner information that is received from a broker-dealer or a bank.[15]

Obviously, before any change is made to the NOBO/OBO system, there should be adequate notice to all investors of the elimination of the OBO classification, so that those who are currently classified as OBOs can have adequate time to consider whether to establish a nominee account.

The Benefits of Transferring Proxy Voting Authority to Beneficial Owners

As noted earlier, financial intermediaries do not typically transmit actual proxy cards to beneficial owners holding in street name as a part of the proxy solicitation process. While some banks do send proxy cards to their beneficial holders, broker-dealers and many banks use a VIF for beneficial owners to indicate their voting preferences for an annual or special shareholder meeting. Under this process, a broker-dealer or bank receives and retains an omnibus proxy from DTC, an instrument that formally transfers proxy voting authority to these financial institutions.

As part of a direct communications system, the Coalition has recommended that the SEC also require broker-dealers and banks—either individually or through DTC—to execute their own omnibus proxy in favor of their underlying beneficial owners.[16] This would permit public companies to send proxy voting cards to beneficial owners in the same manner as registered shareholders. This change would also allow beneficial owners the ability to attend an annual

[15] *See* 17 C.F.R. § 248.14(a), 17 C.F.R. § 248.14(b)(2), and 17 C.F.R. § 248.15(a)(7)(i). Similar privacy provisions apply to banks.

[16] Many institutional investors use a proxy voting service called ProxyEdge to cast their votes. None of the proposals suggested by the Coalition are intended to change the ability of institutional investors to continue to use this service.

meeting—and vote in person at that meeting—without having to obtain a legal proxy from their broker-dealer or bank.

This omnibus proxy proposal also finds support in the academic community. In his seminal 1988 law review article on the SEC's shareholder communications rules, Professor Robert Brown of the University of Denver College of Law recommended the following:

> With respect to the direct mailing of proxy cards, brokers and banks should be required to issue an omnibus proxy in favor of beneficial owners. Thereafter, the proxy card can be mailed directly. Already depositories execute omnibus proxies in favor of participants; banks execute omnibus proxies in favor of respondent banks.[17]

A second commentator, Shaun M. Klein, also recommended this approach in a 1997 law review article:

> Brokers and banks would have to issue blanket omnibus proxies in favor of all beneficial owners, thereby allowing proxy cards to be mailed directly to the real owners. The universal omnibus proxy would eliminate brokers and banks from the voting process, placing decisions about corporate governance where they should be—with investors.[18]

The transfer of proxy voting authority to beneficial owners would ensure that investors holding their shares in street name would receive the same type of proxy cards that registered shareholders receive from each company's transfer agent. This would simplify the shareholder voting system and ensure a more accurate tabulation of final vote counts at shareholder meetings.

<u>The Importance of Ensuring a Quorum at a Shareholder Meeting</u>

Over the years, one criticism of this omnibus proxy proposal has been its potential impact on the ability of a public company to obtain a quorum at a shareholder meeting. In his 1988 law review article, Professor Brown offers the following suggested solution to address this concern:

> At first glance, an omnibus proxy approach might seem to make a quorum more difficult to obtain. Under the existing system, the [NYSE] ten-day rule allows brokers to vote uninstructed shares for purposes of achieving a quorum and for noncontroversial matters. By executing an omnibus proxy and mailing proxy cards directly, brokers are essentially eliminated from the voting process. To the extent that large numbers of beneficial owners failed to return proxy cards, issuers might have trouble obtaining a quorum. No

[17] J. Robert Brown, Jr., *The Shareholder Communications Rules and the Securities and Exchange Commission: An Exercise in Regulatory Utility or Futility?*, 13 J. Corp. L. 683 (Spring 1988), at 787-788, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=993866 (hereinafter "Brown Article").

[18] Shaun M. Klein, *Rule 14b-2: Does It Actually Lead to the Prompt Forwarding of Communications to Beneficial Owners of Securities?*, 23 J. Corp. L. 155 (Fall 1997), at 10, *available at* http://www.dentons.com/en/shaun-klein.

> longer would the ten-day rule ensure sufficient shares present for a quorum. There is, however, an obvious solution. An issuer could provide brokers with a list of unvoted shares; shares for which no proxy had been returned. The broker could execute a proxy for the unvoted shares. The second proxy would revoke the initial proxy, at least with respect to the unvoted shares, and enable the shares to be counted for quorum purposes and for noncontroversial matters.[19]

A version of this suggested solution was also offered by the New York Stock Exchange in a 2006 Report issued by its Proxy Working Group:

> As discussed above, without allowing brokers to vote uninstructed shares some issuers (especially small and mid-cap issuers) may have difficulty achieving quorums at stockholders meetings. One alternative to address the competing needs at issue is to grant brokers the limited authority as record owners to represent unreturned or uninstructed proxies at shareholder meetings for the sole purpose of establishing a quorum. Under this proposal, broker discretionary voting would be eliminated completely, with the NYSE granting brokers the limited authority as record owners to represent unreturned or uninstructed proxies at shareholder meetings for the sole purpose of establishing a quorum.[20]

A second alternative to the potential quorum issue is to add conditional language to the omnibus proxy instrument, which authorizes the broker-dealer, bank, or other intermediary to vote the shares of any unreturned proxies for the limited purpose of establishing a quorum for the shareholder meeting. This alternative also appears to be consistent with existing SEC rules.[21]

Conclusion

The SEC should use its rulemaking authority to eliminate the NOBO/OBO classification system, in order to provide an information-sharing mechanism—or "pass through"—of shareholder identity and contact information from financial intermediaries to companies and their agents. The NOBO/OBO regulatory framework has outlived its usefulness and now serves

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[19] *Brown Article* at 788. Shaun Klein makes the same recommendation in his article cited above ("Quorum problems may arise from the direct communications system with the blanket omnibus proxy, but the method could allow brokers and bankers to execute the unvoted shares. Allowing all nominees to vote their uninstructed shares would vastly improve the current system in which only brokers can vote their uninstructed shares, while banks cannot.").

[20] New York Stock Exchange, *Report and Recommendations of the Proxy Working Group of the New York Stock Exchange*, June 5, 2006, at 18-19. The Report also stated that counting broker votes for quorum purposes does not appear to be a settled matter under Delaware law, although it cited a Delaware Supreme Court case, *Berlin v. Emerald Partners*, 552 A.2d 482 (Del. 1989), in which the court held that a limited proxy can be counted for the purpose of establishing a quorum, even where it is neutral in other respects.

[21] *See* 17 C.F.R. § 240.14a-4(b)(1) ("A proxy may confer discretionary authority with respect to matters as to which a choice is not specified by the security holder provided that the form of proxy states in bold-face how it is intended to vote the shares represented by the proxy in each such case.").

as a significant barrier to direct and ongoing communications between a public company and its shareholders.

In a more modernized shareholder communications system, investor privacy interests can still be protected by permitting individual investors to affirmatively decide to hold their shares in nominee form, as some institutional investors choose to do so today.

If public companies are permitted to obtain a list of all their beneficial owners for corporate communications purposes, then the SEC should also consider requiring broker-dealers, banks, and other financial intermediaries to issue an omnibus proxy—either directly or through DTC—to permit their beneficial owners to receive and return proxy voting cards to the tabulator at a shareholder meeting, in the same manner as registered shareholders return such proxy voting cards.

The implementation of all of these reforms will permit more robust shareholder communications and an improved proxy voting system, for the benefit of all participants in the U.S. proxy system.

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Thank you for the opportunity to comment on the SEC's proposed Transfer Agent Regulations. Please contact me at [redacted] or at [redacted] with any questions, or if the SEC staff requires additional information from the Shareholder Communications Coalition.

Sincerely,

Niels Holch
Executive Director
Shareholder Communications Coalition

cc: The Honorable Mary Jo White
The Honorable Kara Stein
The Honorable Michael Piwowar
Stephen Luparello, Division of Trading and Markets
Keith Higgins, Division of Corporation Finance