

# Securities Transfer Association: Report on Industry Efforts to Improve the U.S. Proxy Voting System

September 23, 2014

## I. Introduction

For the past three years, the Securities Transfer Association (“STA”) has been working with Broadridge Financial Solutions (“Broadridge”), INVeSHARE, Mediant Communications, several broker-dealers, the Depository Trust Company, Business Roundtable, National Investor Relations Institute, Society of Corporate Secretaries & Governance Professionals, Investment Company Institute, and the Council of Institutional Investors to improve the back-office “plumbing” in the proxy voting system.

The catalyst for these efforts was a report published by the University of Delaware in 2011, which, among other proxy voting issues, evaluated the mechanics of providing electronic confirmation to investors that their proxy votes were cast as directed.

The University of Delaware report identified and described a number of problems in the proxy voting system. The report also recommended a series of solutions that could be implemented without amending current federal regulations.

After the University of Delaware report was issued, the STA, Broadridge, and other proxy voting participants formed an End-to-End Vote Confirmation Working Group (“Working Group”) to address the problems identified in the report and develop standardized processes to resolve them.<sup>1</sup>

This paper reports on the work of this End-to-End Vote Confirmation Working Group, which culminated in a pilot project during the 2014 proxy season, to beta test the new communications portals and reconciliation procedures developed by the Working Group.

## II. Background on the Vote Confirmation Problem

An issue that has been frustrating to institutional investors and public companies for several years now is the inability of the current proxy voting system to confirm to investors that their votes at shareholder meetings are recorded by the tabulator according to their instructions.

A number of institutional investors have advocated for a standardized operational process to address this problem. As an example, the Council of Institutional Investors

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<sup>1</sup> As explained in the conclusion to this report, the STA does not believe that a comprehensive “end-to-end” solution to the problems in the existing proxy voting system can be accomplished until the system is simplified and made more transparent.

adopted a Statement on Principles for an Effective and Efficient Proxy Voting System in April 2010.<sup>2</sup> Two key points from the CII’s Statement are:

- **Accuracy**—All votes properly cast should be correctly tallied.
- **Certainty**—The proxy voting system should provide for end-to-end confirmation enabling both companies and shareowners to confirm that votes properly cast were included in the final tally as directed.

In response to the concerns expressed by these members of the institutional investor community, the vote confirmation issue was raised by the Securities and Exchange Commission (“SEC”) in its July 2010 Concept Release on the U.S. Proxy System.<sup>3</sup>

Comment letters on this Concept Release from investors and issuers reinforced the need to address this problem:

- Council of Institutional Investors: “The Council understands that the complexity of the current voting chain presents special challenges for confirmation from an operational perspective. ... We believe the current framework, and particularly its dependence on voluntary information sharing, strengthens the argument for adopting means to assure that votes are tallied correctly.”<sup>4</sup>
- Investment Company Institute: “... [ICI members] have experienced difficulties in confirming votes they cast in their capacity as institutional shareholders due either to the complexity of the current process, its lack of transparency, or because participants in the voting process are unwilling or unable to share voting information with each other or with investors. ... In particular, the Commission should adopt a rule imposing a standardized method—with specified time frames—that issuers (or their agents) must use to confirm votes upon request by a shareholder.”<sup>5</sup>
- National Investor Relations Institute: “NIRI believes requiring vote tabulators, securities intermediaries and proxy service providers to provide each other

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<sup>2</sup> Council of Institutional Investors, Statement on Principles for an Effective and Efficient Proxy Voting System, April 13, 2011, available at <http://www.cii.org/UserFiles/file/Statement%20on%20Principles%20for%20Proxy%20Voting.pdf>.

<sup>3</sup> Securities and Exchange Commission, Concept Release on the U.S. Proxy System, 75 Fed. Reg. 42,982 (July 22, 2010). See *Id.* at 42,992 (“The inability to confirm that votes have been timely received and accurately recorded creates uncertainty regarding the accuracy and integrity of votes cast at shareholder meetings.”)

<sup>4</sup> Letter from Glenn Davis, Senior Research Associate, Council of Institutional Investors, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, at 1-2, October 14, 2010, available at <http://www.sec.gov/comments/s7-14-10/s71410-80.pdf>.

<sup>5</sup> Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, at 5, October 20, 2010, available at <http://www.sec.gov/comments/s7-14-10/s71410-167.pdf>.

with access to vote data so investors and issuers can confirm that votes have been received and tallied according to investor voting instructions would help to eliminate [voting errors]. This would also begin moving toward the end-to-end confirmation important to restoring voting integrity in our proxy system and confidence in our capital markets.”<sup>6</sup>

- Society of Corporate Secretaries & Governance Professionals: “The Society recommends that the SEC require tabulators, transfer agents, and/or other intermediaries to make vote confirmation available for all meetings, regardless of who is acting as tabulator, without increasing the costs to issuers.”<sup>7</sup>

As noted earlier, the STA Proxy Committee and a group of broker-dealer agents established a technical working group in April 2012 called the End-to-End Vote Confirmation Working Group to seek a solution to this issue.

The goal of the Working Group has been to ensure that vote tabulators, securities intermediaries, and proxy service providers develop a standardized method—with specified time frames—to provide each other with access to proxy vote data so that investors can confirm that votes have been received and tallied according to their instructions.

The members of the Working Group are listed in Appendix A.

### III. Brief Description of the Current Proxy Voting System

As is well-known to participants in the proxy system, the United States uses a “street name” system in which the physical shares of a public company are held in a depository institution. The largest U.S. depository is the Depository Trust Company. Similar depositories in Canada and Europe include the Canadian Depository for Securities Limited, EuroClear, and Clearstream.

These depositories register and hold corporate securities in “nominee” name for financial institutions, such as broker-dealers and banks, which are participants in this system. By holding securities in nominee name, these depositories are able to facilitate the transfer of securities through computerized book-entry systems, instead of having to physically move stock certificates or formally transfer record ownership.

Approximately 75% of corporate shares are registered in nominee name with a broker-dealer or a bank within the street name process. Another 25% of corporate shares are registered directly with a company’s transfer agent.

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<sup>6</sup> Letter from Jeffrey D. Morgan, President & CEO, National Investor Relations Institute, to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, at 5-6, October 21, 2010, available at <http://www.sec.gov/comments/s7-14-10/s71410-211.pdf>.

<sup>7</sup> Letter from Katherine Combs, Chair, Interim CEO & President, Society of Corporate Secretaries & Governance Professionals, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, at 6, November 22, 2010, available at <http://www.sec.gov/comments/s7-14-10/s71410-276.pdf>.

Almost all broker-dealers and banks outsource their proxy processing functions to a third-party service provider, which acts as their agent. The largest broker-dealer agent is Broadridge.<sup>8</sup> Other broker-dealer agents include INVeSHARE and Mediant Communications.<sup>9</sup>

The substantial majority of tabulators are transfer agents, which do not have access to beneficial owner information below the nominee level. Beneficial owners—whether institutional investors or individual investors—are known to their respective broker-dealers or banks, which act as recordkeepers for the share positions they hold.

When Broadridge is serving in multiple roles—such as a broker-dealer agent, the tabulator, and the transfer agent for a company—it is able to provide vote confirmation to investors without communication with other service providers, as most, if not all, shareholder voting is processed through its systems. However, this occurs in a limited number of circumstances as more than 80% of the annual or special meetings involve transfer agents as tabulators, as well as other service providers.

In order for vote confirmation to be a reality under the current system, an industry information-sharing protocol needs to be established among all service providers, so that voting information can be shared among vote tabulators and other proxy service providers.

#### IV. Proposed Solutions to the Vote Confirmation Issue

A. The University of Delaware Report Recommendations. In December 2010, the Weinberg Center for Corporate Governance at the University of Delaware (“University of Delaware”) convened an industry Roundtable to: (1) identify issues in the proxy voting chain; and (2) suggest achievable solutions to proxy voting problems. The goal of the Roundtable participants was to develop recommendations which could be implemented over a reasonable timeframe and without the need for federal regulation.

The University of Delaware released its Roundtable Report on August 4, 2011, with recommendations for improving the ability of investors participating in the proxy process to request and receive confirmation that their votes were cast as instructed.<sup>10</sup>

Among the recommendations in the Roundtable Report was a proposed process by which tabulators, nominees, and proxy service providers would furnish each other

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<sup>8</sup> Broadridge also serves as a transfer agent for a number of public companies.

<sup>9</sup> INVeSHARE is a broker-dealer agent that delivers regulated shareholder materials to retail investors and, through integration with a brokerage firm’s website, permits retail investors to vote online. Mediant Communications provides shareholder communications and proxy voting services to broker-dealers through its Broker Services Division.

<sup>10</sup> University of Delaware, Report of Roundtable on Proxy Governance: Recommendations for Providing End-to-End Vote Confirmation, August 4, 2011, available at [http://www.broadridge.com/investor-communications/us/UniversityDelaware\\_Report.pdf](http://www.broadridge.com/investor-communications/us/UniversityDelaware_Report.pdf).

with sufficient information to permit an investor to confirm that its vote was submitted to the tabulator and tallied properly.<sup>11</sup>

The specific recommendations of the Roundtable participants on the vote confirmation issue are reprinted in Appendix B to this document. These recommendations have been the starting point for the Working Group, in encouraging the development of a standardized method to permit vote confirmation by investors.

B. Broadridge/Transfer Agent Discussions. Since April 2012, the STA Proxy Committee, Broadridge, and other broker-dealer agents have been in regular discussions through the End-to-End Vote Confirmation Working Group to develop operational protocols to implement all of the proxy voting recommendations of the University of Delaware Report referenced above.

To date, these technical discussions have resulted in the development of new procedures to:

- permit investors to receive electronic confirmation that their proxy votes were cast as instructed;
- develop best practices for determining, reporting, and resolving vote discrepancies presented to the vote tabulator;
- improve the early-stage vote entitlement process; and
- strengthen the coordination among parties involved in the omnibus proxy process.

C. Information-Sharing Between Tabulator and Other Parties. The Working Group has developed a standardized process to facilitate vote confirmation to be made by the issuer's tabulator back to an investor holding in street name and requesting such validation.

The Working Group has developed a protocol by which the issuer's tabulator will acknowledge receipt of voting instructions from a nominee's agent on a daily basis and either confirm acceptance of the vote or inform the agent of the number of votes not accepted.

If an acceptance is made, it will be at the nominee level, as the aggregation of shares in the street name system does not currently provide the issuer's tabulator with the ability to confirm votes at the beneficial owner level.

If the issuer's tabulator is able to confirm back to the nominee's agent that the nominee's aggregate position was voted in accordance with the nominee's instructions,

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<sup>11</sup> Id. at 13.

the nominee is in a position to report back to its client that the client's vote was received, accurately recorded, and included in the final tabulation of votes.

Since a nominee may report its position in stages, the issuer's tabulator will only be able to confirm to the nominee's agent when the entire position has been successfully voted. At that point, the nominee's agent will then be able to confirm back to an investor that the issuer's tabulator has accepted the votes without any rejection.

Attached to this report in Appendix C is a non-technical description to explain the manner in which the vote confirmation process has been standardized. This description is intended to reflect the perspective of the institutional investors which will use this process for vote confirmation purposes.

D. Standardized Methodology for Addressing Vote Discrepancies. One significant issue in the vote confirmation process is the problem of votes being submitted in excess of what the tabulator knows to be the maximum share position for a nominee (or group of nominees) at the primary depository institution, the Depository Trust Company ("DTC").

The Working Group was presented with the following example to illustrate this problem:

A broker-dealer has a share position at DTC of 1 million shares as of the issuer's record date for its annual meeting. At an early stage of the proxy voting process, the broker-dealer's agent submits instructed votes for 800,000 of the issuer's shares to the tabulator. A few days later, at a later stage in the voting process, the broker-dealer's agent submits instructed votes for 400,000 additional shares to the tabulator.

Under this fact pattern, the tabulator is unable to confirm that all votes have been tallied as instructed because of a discrepancy between the DTC share position of 1 million shares and the submitted votes for 1.2 million shares. This problem is called "over-voting," as votes for 200,000 shares have been submitted in excess of the DTC position for this particular nominee.

This is a problem for the tabulator because it is responsible for reconciling the total voted shares for each nominee against the number of shares entitled to be voted. The current procedure used by many tabulators is to initially accept the submitted votes and then attempt to resolve the discrepancy using its exception processing procedures.

The vote discrepancy described above could be the result of one or more of the following factors:

- the shares are held in a non-DTC depository (e.g. EuroClear, Clearstream, CDS);

- the shares are held by DTC participants on behalf of respondent banks and correspondent brokers and such holdings are not identified to the tabulator;
- the shares are held by DTC participants with multiple DTC accounts;
- the shares are corporate treasury shares that are not separately identified to the tabulator;
- the shares are held by a nominee not otherwise accounted for in the DTC participant system;
- the shares are held in directly registered form; or
- the shares are subject to share lending activities and/or are subject to a failure to deliver at settlement.

If the issuer’s tabulator is unable to resolve the vote discrepancy involving this nominee, the STA Proxy Committee has proposed several alternatives for handling the shares submitted in this proxy voting example.<sup>12</sup> However, the Working Group has not yet formed a consensus on a uniform method for how a tabulator should handle unresolved vote discrepancies.

It is the STA’s view that voting discrepancies will still occur until there is an SEC rule that requires pre-mailing reconciliation of eligible shares at both the nominee and beneficial owner levels. Progress is being made to improve reconciliation at the nominee level, as will be reported below. However, the brokerage community does not uniformly reconcile eligible voters and shares at the investor level before a proxy distribution is made.

E. Other Proxy Voting Issues Impacting Vote Confirmation. The current proxy voting system is quite complex, with many components to it. The system also has a number of different intermediaries involved, from depository institutions to proxy service providers. It is clear that the vote discrepancy problem discussed above—and the ability of a tabulator to confirm that all shareholder votes have been tallied as instructed—depends on various operational processes that take place after an issuer’s record date and before proxy materials are actually distributed. Two of these processes are quite important to the accuracy of the final vote count and are part of the technical discussions by the Working Group:

1. Early-Stage Vote Entitlement. To reduce discrepancies in the tabulation stage of the proxy voting process, it is important to determine the number of shares that each broker-dealer and bank is authorized to vote. This vote entitlement

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<sup>12</sup> See T.L. Montrone, “Over-Voting ‘Practices’ – A Review,” STA Newsletter, October 2012.

process at the nominee level should occur as soon after the record date as practicable.

The operational process will start with the production of a Securities Position Report for each issuer by the Depository Trust Company. This will serve as the baseline for the vote entitlement at the nominee level. The issuer's tabulator and the service providers to the nominees will receive the same file.

Broadridge has established a communications platform to allow nominees and the issuer's tabulator to reach agreement on the number of shares each nominee has the authority to vote. Standardized communication templates have been developed to provide efficient and error-free exchanges of information between nominees and tabulators. The purpose of this new communications portal is to encourage reconciliation of nominee share positions at an earlier stage of the voting process.

2. Omnibus Proxy Process. Since depository institutions like DTC are the actual shareholders of record for a security, these depositories issue omnibus proxies to their participant broker-dealers and banks. These omnibus proxies transfer voting authority for the shares held by these nominees as of the record date of a particular issuer.

Broadridge, with input from transfer agent tabulators, has developed an automated system to handle the omnibus proxy process, in order to allow for a prompt determination of a nominee's entitlement to vote in a particular shareholder meeting. The omnibus proxy system developed by Broadridge directly addresses the respondent bank problem noted earlier and has helped significantly in this area. Although some of the other position discrepancy types mentioned earlier might be resolved with omnibus proxies, an automated system to produce them has yet to be developed.

A procedure has being developed by which omnibus proxy files would be produced for tabulators within four (4) business days of a record date. Many transfer agent tabulators are already making use of this system, and the Working Group will examine whether expansion of this facility will reduce some of the manual workload involved in using the communications portal described above.

## V. The 2014 Proxy Voting Pilot Project

To beta test these new communications and reconciliation systems, the members of the Working Group agreed to initiate a pilot project for the 2014 proxy season. This 2014 pilot involved 26 issuers, Broadridge, several broker-dealers, and 5 transfer agent tabulators.

The communications portal referred to above serviced 174 reconciliation requests. These requests involved the following issues:

- shares being held at a non-DTC depository;
- nominees with multiple DTC accounts;
- shares held in directly registered form; and
- shares subjected to share lending.

Most of the reconciliation requests came from nominees seeking to verify their voting entitlement in connection with shares held in the Canadian Depository for Securities Limited (“CDS”) account at DTC. The CDS position at DTC is held in a single account and in aggregated form. Many U.S. tabulators do not receive information on the underlying nominee positions within this aggregated account for reconciliation purposes.

Unfortunately, the level of participation in the pilot from U.S. brokers was very low. The Working Group is still analyzing the results of the pilot to determine what contributed to this factor.

All Working Group participants in the pilot also reported that, at present, resolving the reconciliation requests involved manual processing steps that were very time-consuming and cumbersome. The Working Group has concluded that the development of automated systems to replace manual ones is critical to sustain more widespread use of the communications portal.

It is important to note that the over-voting prevention service offered by Broadridge, which reconciles nominee positions with DTC positions, may already be resolving a number of the reconciliation problems. This service is expected to be implemented for all Broadridge clients at some point in the future.

It is also important to note that the communications portal was designed to provide a resolution mechanism at an early stage of the voting process and in cases where a nominee’s internal client account adjustments fail to resolve the imbalance.

## VI. Conclusion

While progress has clearly been accomplished in providing investors with the ability to receive electronic confirmation that their votes were cast as directed, more work needs to be done. The end result of vote confirmation cannot be accomplished with complete accuracy until other proxy voting issues within the street name system are addressed.

The most important of these issues involves reconciliation of the entitlement of each investor to vote a share position as of the record date. Reconciliation needs to occur at both the nominee level and at the beneficial owner level.

The Working Group has taken a number of steps to improve significantly the nominee reconciliation process, by improving the coordination between nominee agents and tabulators working for issuers. Broadridge's over-voting prevention services and its new communications portal are two of the solutions that are reducing proxy vote discrepancies at the nominee level.

The STA was disappointed that U.S. broker-dealers did not participate in a meaningful manner in the 2014 pilot project, to help the Working Group beta test its new communications and coordination protocols. The STA also believes the proxy voting system would be improved through reconciliation of the vote entitlement at the beneficial owner level before a proxy distribution is made. This reconciliation would determine eligible voters and share positions in a uniform manner for broker-dealers and banks holding street name shares.

It is important to note, however, that reconciliation of a nominee's position at the beneficial owner level will not resolve the voting entitlement discrepancies that were the subject of the pilot project. Equal attention needs to be given to reconciliation at the nominee level to ensure that all of a nominee's shares entitled to be voted have been accounted for.

The STA also believes that as many processing tasks as possible should be standardized and automated, to limit the amount of manual processing required.

The STA intends to continue its work with Broadridge and other broker-dealer agents to build on the progress that has been made and looks forward to further improvements to the vote confirmation process and the overall proxy voting system.

While the STA fully supports any measures that would improve proxy voting without additional regulation, the STA still believes that the proxy voting system is overly complex and cumbersome. To address this problem over the longer term, the SEC should simplify the system by adopting substantive reforms to make proxy voting more transparent and to ensure a higher level of accuracy in the vote count.

In addition to the pre-mailing reconciliation recommendation mentioned above, the STA believes that: (1) proxy voting authority should be transferred from nominees to the beneficial owner level; and (2) issuers should be able to solicit proxies directly, through the elimination of the NOBO/OBO classification system and through amended federal regulations that place the responsibility for distributing proxy materials with the public companies themselves, using service providers of their own choosing. The STA is also convinced that an industry solution can be worked out to permit street name unvoted shares to be cast for routine items in order to achieve quorum for shareholder meetings.

Appendix A: End-to-End Vote Confirmation Working Group Participants

American Stock Transfer & Trust  
Bank of America/Merrill Lynch  
Bank of New York Mellon  
Broadridge Financial Solutions  
Computershare  
INVeSHARE  
Mediant Communications  
National Financial Services  
Registrar and Transfer Company  
Wells Fargo Shareholder Services

## Appendix B: Recommendations by the University of Delaware Roundtable on Proxy Governance Regarding Vote Confirmation

Following their discussions of the various steps that underlie the proxy voting process, the participants in the University of Delaware Roundtable on Proxy Governance offered the following recommendations on vote confirmation in the Roundtable Report of August 4, 2011:

- In developing vote confirmation functionality, and in order to manage the costs associated with the effort, the Roundtable believes that the process should enable investors to obtain, via the internet or other electronic means, a vote confirmation on a demand or as needed basis. This could be accomplished by the use of secure websites with security protections and other controls to maintain confidentiality.
- The votes of both registered and street name shareholders may contain discrepancies in the instructions furnished to tabulators. Because the identities of individual street name owners are unknown to the tabulator, the tabulator is unable to confirm individual votes without a “unique identifier” or some other device to facilitate the confirmation process.
- Currently, each street name owner possesses a unique control number that appears on his or her Voting Instruction Form (VIF). A record of each VIF control number submitted to the nominee is currently kept, and the nominee keeps a record of how that particular VIF was voted in the aggregate vote position that the nominee submits to the tabulator.
- If the tabulator confirms back to the nominee that the nominee’s aggregate position was voted in accordance with the nominee’s instructions, the nominee will then be able to confirm back to its client that the client’s vote was received on a timely basis, accurately recorded and included in the final tabulation of votes, thus completing the confirmation “chain” from tabulator to nominee to shareholder. Because a nominee may report its position in stages, the tabulator will only be able to confirm to the nominee when the entire position has been voted.
- In the case of shares held in street name, the Roundtable recommends that existing VIF control numbers serve as the unique identifier needed to facilitate vote confirmation. The Roundtable recognizes that to the extent vote confirmation imposes additional duties on tabulators and nominees, additional charges for vote confirmation services may be appropriate.

## Appendix C: Description of the Proxy Vote Confirmation Process

1. Investor requests vote confirmation from its nominee (broker-dealer or bank).
  - Process can be accessed by institutional or individual investor.
  - Process can be accessed by street-name holder or registered holder.
  - Registered holder may deal directly with tabulator.
2. Nominee forwards confirmation request electronically to its broker-dealer/bank agent for processing.
  - Investor or nominee with shares registered with transfer agent makes request directly to tabulator.
3. Broker-dealer/bank agent submits electronic request for acknowledgement that specific nominee's shares were tabulated as instructed.
4. Tabulator confirms that nominee's aggregate position was voted in accordance with the nominee's instructions for street name holders.
  - Tabulator confirms that a specific share position was voted in accordance with the investor's instructions for registered holders.
  - If tabulator cannot accept the votes of a particular nominee, then procedures for exception processing are implemented, with a resolution at the nominee level for street name shares.
5. Broker-dealer/bank agent communicates back to nominee appropriate vote confirmation information using Vote Instruction Form ("VIF") control number(s). Nominee communicates vote confirmation information to investor.
  - Nominee or investor with shares registered with transfer agent receives vote confirmation directly.
  - A vote confirmation Internet portal may be created for street name holders, permitting them to enter an identifying number and learn if their shares have been received by the tabulator and tallied according to their instructions.