



Client Directed Voting

Selected Issues and Design Perspectives

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Council of Institutional Investors
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Executive Summary

In the world of proxy mechanics, one of the “next new things” is client directed voting (CDV). CDV is intended to respond to low and declining levels of proxy voting by retail beneficial owners — *i.e.*, individual shareowners or RBOs — and in particular to recent changes to Rule 452 of the New York Stock Exchange (NYSE) that prohibit uninstructed broker voting in uncontested director elections. Forthcoming changes to that rule under the recently-enacted financial reforms will further narrow the matters on which brokers may vote uninstructed shares. While there are many formulations of CDV, all involve a process by which an RBO can provide some form of advance voting instructions to an entity authorized to vote his or her shares, subject to the RBO’s ability to override the instructions. The most important variations among these formulations are intended to promote more informed RBO voting decisions through, for example, access to institutional voting decisions or guidelines. The Securities and Exchange Commission (SEC) has solicited comment on how this model, which it refers to as “advance voting instructions,” might operate as part of its recent “concept release” on proxy voting and shareowner communications (concept release).

There is broad consensus about the importance of RBO participation. There is much less agreement with respect to whether CDV is an appropriate means to increase participation, or what would be the most effective CDV design. Much of the debate centers around what problem CDV is intended to address — broadly speaking, whether the goal should be to streamline voting mechanics so as to increase voting levels or to create a model that facilitates more informed voting. How commentators balance the relative importance of these goals informs their views about the best approach to many key features of CDV, such as the scope of proposals covered; available voting choices; and whether and how frequently an RBO must reaffirm advance instructions.

Because increased RBO participation has the potential to influence the outcome of at least some matters, whether and in what form CDV might be implemented are of importance to institutional investors and companies. A CDV model that has the effect (even if unintended) of creating a standardized voting mechanism that is viewed as little different from uninstructed broker voting would be of great concern to institutions. Some CDV models would also permit RBOs to mirror institutional voting decisions (mirror-voting). This approach could raise questions about confidentiality in voting since it would effectively require advance disclosure of institutional voting decisions. Some institutions have also questioned this approach, as a matter of principle more than liability exposure, because they owe a fiduciary duty only to their own investors. This point raises the issue of the desirability or appropriateness of RBO voting that mirrors institutional voting. Finally, companies and/or institutional investors may directly or indirectly bear some implementation costs of CDV, depending on the approach taken.

From a regulatory perspective, CDV presents a fundamental policy issue. Under any CDV model, RBOs would set voting instructions before disclosure about the matters in question is available and before the specific matters are known — indeed, in some iterations of CDV, before the shareowner even owns stock in a company for whose annual meeting the instructions would apply. This is in stark contrast to the current proxy framework that does not permit voting in the absence of highly detailed disclosures intended to provide appropriate context for voting decisions. As a matter of public policy, it is far from clear how the SEC will balance the independent value it ascribes to RBO participation against the disclosure and investor protection principles underpinning the current framework. The SEC must also evaluate whether the features of CDV intended to address this concern — the ability to revoke advance instructions and periodic reaffirmation of advance instructions — are sufficient.

CDV proponents have countered this policy concern by asserting that institutional investors essentially set advance voting instructions now through their reliance on proxy advisory firms — an approach, they argue, that is worse than CDV, since those firms have no economic interest in the companies that are the subject of their voting recommendations. In their view, CDV merely levels the playing field. While this is a compelling goal, the analogy to institutional practices is

imperfect. Those practices vary substantially, and assertions that institutions uniformly “outsource” the voting function are simply unfounded. Moreover, in light of their fiduciary duties, institutions review their voting practices and decisions each year, an obligation not shared by RBOs. Institutions also have regular means of providing input into the published guidelines of proxy advisory firms and often develop bespoke guidelines in consultation with those firms. This reflects a level of systematic and recurring engagement — largely due to fiduciary obligations — that would be unlikely among RBOs. Moreover, that institutional practices have evolved in this direction does not require, as a matter of policy, that the model be extended to RBOs if that result would be inconsistent with fundamental principles of investor protection.

On the other hand, some features of the current proxy voting system may now operate to marginalize RBO participation. That situation merits attention by all participants and the SEC, and CDV merits consideration as one potential solution. CDV merits consideration as one potential means to address the problem. To date, much of the dialogue about CDV has been conceptual and, while some have begun to consider operational details, many practical implementation issues are unresolved. Lack of empirical data about the demand for CDV, its potential effectiveness to meet any particular set of goals and its cost implications is likely to create challenges in evaluating the design and potential effectiveness of any particular CDV model.

The complexity of CDV and the policy and regulatory issues it entails suggest to us that a robust CDV model is likely to have a long gestation period, particularly since any CDV model must be considered in light of the wide range of proxy infrastructure questions that the SEC is now raising as part of its concept release. Other regulatory changes may be more expeditious and, possibly, more effective tools to increase RBO participation. Regulatory changes that would simplify the voting framework and enhance communications generally, such as through the elimination or adjustment of the OBO/NOBO framework to favor disclosure of shareowner identities or by promoting more robust broker-dealer online voting platforms, seem to us to be a more effective approach that should merit priority consideration. Perhaps more importantly, at least some of these other reforms can be achieved — in contrast to CDV — in a way that does not require consideration of investor protection principles that underpin the SEC’s proxy rules.

Introduction

In the world of proxy mechanics, one of the “next new things” is client directed voting. CDV has been advanced by companies and shareowner advocates in response to low and declining levels of proxy voting by retail beneficial owners — *i.e.*, individual shareowners or RBOs¹ — and in particular to recent changes to NYSE Rule 452 that eliminate uninstructed broker voting in uncontested director elections. Forthcoming changes to that rule under the recently-enacted financial reforms will further narrow its impact by eliminating broker uninstructed voting on compensation matters and “any other significant matter.” as determined by the SEC.² While there are a number of different formulations of CDV, all involve a process by which an RBO can provide some form of advance voting instructions to an entity authorized to vote his or her shares, subject to the RBO’s ability to override the instructions. The SEC has itself expressed interest in the concept, which it refers to as “advance voting instructions,” and its recently issued concept release on proxy infrastructure seeks public comment on several questions about how CDV might operate.³

There is no serious debate about declining levels of RBO participation.⁴ There is, however, considerable discussion about many related topics, including the voting levels attained for various subsets of RBOs, whether CDV or other techniques will be most effective in increasing participation and whether CDV will (and, indeed, whether it should be designed to) just increase RBO voting or enhance the level of RBO engagement with the issues and therefore increase informed voting as well.

There are acknowledged hurdles to increasing RBO participation. Time constraints are often cited,⁵ and the length and complexity of proxy materials and the compressed annual meeting season exacerbate the problem. RBOs may also believe that their brokers are voting for them, or they may be confused by the process generally.⁶ Economists cite “rational apathy” — the failure to vote owing to a perception that no individual vote has practical impact when voting is widely diffused — as another explanation.⁷ RBO voting statistics may also simply indicate that they accord less relative value to this component of their investments. Unlike institutions, which vote at rates in excess of 90 percent,⁸ RBOs are not required to vote, are not generally constrained by investment guidelines and do not perceive themselves as subject to other factors that can drive a longer-term ownership perspective and therefore greater engagement.

As noted above, the CDV model would allow RBOs to provide revocable advance voting instructions to an entity authorized to vote their shares. Its proponents argue that CDV extends to RBOs a tool widely used by institutions that rely on proxy advisory firms to vote their shares or provide issues-based “filters” to distinguish routine shareowner meetings from those involving special issues. Several iterations of CDV have been proposed, varying in approach to key features, such as the scope of proposals covered; available voting choices; and whether and how frequently an RBO must reaffirm advance instructions. The design of a CDV model depends of course on the problem it is intended to address. A CDV model aimed more directly at promoting informed voting could look very different from one intended to increase RBO participation through a more streamlined voting process.⁹ CDV proponents and commentators on its prospects have uniformly emphasized ease of use as critical to CDV’s success, but generally not at the expense of promoting informed voting through a continued focus on timely, high quality disclosure and educational tools. Interested constituencies vary in how they would balance these goals.

Increased RBO participation does in fact have the potential to influence the outcome of at least some matters. RBO participation and the impact of CDV are therefore of importance not only to RBOs, but also to institutional investors and companies. A CDV model that increases genuinely volitional RBO voting may be seen as facilitating the exercise of an important shareowner right and thus may have a role in evolving proxy mechanics, even if it does not also enhance RBO understanding of ballot items. On the other hand, a CDV model that facilitates voting through a streamlined process, but that has the effect (even if unintended) of a standardized voting mechanism may be viewed as little different from uninstructed broker voting. That type of model would nullify the modifications to NYSE Rule 452 and be of great

concern to institutional investors. Some CDV models would also permit RBOs to mirror institutional voting decisions. This approach could raise questions about confidentiality in voting since it would effectively require advance disclosure of institutional voting decisions. Some institutions have also questioned the appropriateness of this approach, as a matter of principle more than liability exposure, because they owe a fiduciary duty only to their own investors. Finally, depending on the design and perhaps on the regulatory approach to CDV, companies and/or institutional investors may directly or indirectly bear some implementation costs (e.g., in the case of institutions, through increased regulation about the content of their published voting guidelines).

Meaningful evaluation of CDV is hobbled by the lack of empirical data about the demand for CDV, its potential effectiveness to meet any particular set of goals and its cost implications. Perspectives about CDV are thus anecdotal and speculative at best. In particular, it is unclear whether CDV could increase RBO participation beyond a limited number of more sophisticated RBO investors with enough individual stock positions to make it worthwhile. Without evidence of meaningful demand for CDV and a funding source, intermediaries may not undertake the development and promotional activities needed to create a robust model. Nevertheless, the concept could be appealing and merits further review by regulators, companies and investors.

Against this backdrop, we address below selected considerations relevant to CDV as follows:

- Part II provides background information about the development of the CDV concept and prototypes and alternatives to CDV;
- Part III provides perspectives on the design of a CDV model;
- Part IV addresses other regulatory and logistical considerations that may drive development and acceptance of CDV;
- Part V addresses cost considerations; and
- Part VI concludes with recommendations.

Background and Context for CDV

Development of the CDV Concept

CDV is a relatively new idea. The concept gained currency after the NYSE's Proxy Working Group (PWG) published its analysis of broker discretionary voting under NYSE Rule 452 in 2007. CDV was conceived as a tool to increase RBO participation and a possible way to offset declines from already low RBO voting levels that were expected to follow the end of broker discretionary voting in uncontested director elections.¹⁰ The model considered by the PWG entailed portfolio-wide advance instructions with four voting options: (1) for the board's recommendations, (2) against the board's recommendations, (3) abstain on all matters, and (4) proportionally with the brokerage firm's instructed RBO votes. At the time of a proxy solicitation, an RBO would receive a pre-marked voting instruction form (VIF) from his or her broker reflecting the RBO's advance instructions, but could override the pre-marked votes.

Various parties have continued to advance CDV, notably the Society of Corporate Secretaries & Governance Professionals (SCSGP), which has met informally with the SEC staff to seek interpretive guidance to facilitate CDV.¹¹ Several iterations of the original concept have been proposed as CDV has become more widely promoted. The most important variations are intended to facilitate more informed RBO voting decisions. Informed voting is an appealing goal for regulators, but may also be a critical factor for institutions and others who have a skeptical view of pre-selected voting "defaults" as the practical equivalent of uninstructed broker voting.¹²

The key element of these variations is RBO access to a menu of voting rationales or options based on third-party guidelines or decisions, principally those of institutions. Proposals in this vein have suggested both a centralized, standardized database of this information and more decentralized approaches, such as Internet "voting feeds" that could serve as the basis of, or to inform, RBO advance instructions.¹³ As RBOs repeatedly observe the voting decisions of particular institutions, those institutions would develop specific voting reputations or "brands."¹⁴ RBOs would benefit as they could rely on others with greater resources to evaluate specific governance issues and instead invest their time in analyzing voting "brands." Proponents argue that, even if an RBO cannot, or does not, choose to mirror the vote of another investor, this approach could facilitate greater and more informed RBO participation.

CDV Prototypes

Many components of a CDV model exist online today, although generally not through a single portal. Web sites such as MoxyVote.com, ProxyDemocracy.org, ShareOwners.org and TransparentDemocracy.org are prototypes for a CDV model as they provide services that aim to educate RBOs and increase their participation. For example, ProxyDemocracy aggregates voting decisions of large institutional investors that are published prior to shareowner meetings and summarizes voting records of institutional investors and mutual funds. RBOs using MoxyVote can vote their proxies electronically and can align their votes with "advocates" that publish their votes on the site in advance of a shareowner meeting.¹⁵ Aside from these Web sites, *ad hoc* arrangements exist for some classes of RBOs (mainly high net worth individuals) who may set up advance instructions with their financial advisers.

At the SEC's request to consider ways to increase RBO participation, Broadridge Financial Solutions Inc. (Broadridge) has also considered the operation of a CDV model based in part on ProxyEdge, its suite of electronic voting services for institutional investors. The Broadridge model, a description of which is included in [Annex B](#), emphasizes disclosure, ease

of use and RBO opt-in and control of the final votes cast, all of which are predicates shared with the SCSGP principles discussed in Part III below. While the work is preliminary and inactive pending comments in response to the SEC's concept release, the approach represents the most advanced thinking about the operation and logistical implications of a robust Web-based CDV model.

The absence of an existing online CDV model has several possible explanations aside from potential regulatory impediments. One reason may be lack of demand owing to the same considerations that depress RBO voting generally. Another may be the number and variety of sites, which may present a fragmented and confusing landscape even for RBOs with computer access and facility with online environments. It may also be challenging for any one of these sites to attract a critical mass of RBO users that would make further development and promotional investment worthwhile, at least in the near term. In the absence of empirical analysis, the size of the RBO population that could be expected to migrate to a CDV model and how RBOs might use the model are also uncertain. Finally, at least for large companies, it is almost certainly the case that the outcome of only a relatively small percentage of votes will, as a practical matter, be influenced by increased RBO participation. There may be more cost-efficient and effective ways for companies and insurgents to increase RBO participation when RBO votes could determine the outcome or be important to evaluation of the outcome.¹⁶

One means to promote more rapid adoption of CDV by RBOs in an online environment might be to rely on brokers and (to a lesser extent) banks, which already have relationships with their RBO customers.¹⁷ These intermediaries might readily add CDV to their other online services, although this avenue would require SEC rulemaking, as we discuss in Part IV below. It would also require consideration of costs. There is no empirical data analyzing a subscription-based CDV model, but it is unlikely that most RBOs would be subscribers. Further, as noted above, companies may be more inclined to focus on cases where RBO votes may determine the outcome, rather than support development of a broader-based, but less cost-effective approach to increasing RBO participation. These realities make a reliable business model for CDV still more elusive.

Alternative Initiatives to Promote RBO Participation

There is little dispute that matters subject to a shareowner vote are becoming more meaningful. Votes are also becoming closer for a variety of reasons that include substantive developments, such as increased concern about governance, and procedural ones, such as the changes to NYSE Rule 452. These circumstances have stimulated interest in ways to increase informed RBO participation. Moreover, beyond those cases where the RBO vote may influence the outcome, there are other values that would be served by increased RBO participation, including the desire for a level playing field among different types of investors and investor confidence in the fundamental fairness of the voting process.

CDV is not the only path to increased RBO participation. The SEC has taken steps to address this issue, including its 2010 amendments to the e-proxy rules to permit greater flexibility to design meaningful e-proxy notices and include explanatory materials,¹⁸ and its 2007 amendments to the solicitation rules to facilitate the use of electronic shareowner forums.¹⁹ Consistent with the widely-acknowledged educational challenge presented by low RBO participation, the SEC has also placed investor education materials on its Web site,²⁰ although many question whether these materials will attract the attention of RBOs who are unresponsive to e-proxy. While SEC endorsement (or more) of the CDV model may be another important step, building on these other alternatives should not be ignored.²¹ E-proxy has only been in operation for three years. RBO adoption rates may rise as investors become more accustomed to the system, particularly as a generation of more technologically savvy investors comes of age, and companies and insurgents (and their agents) become more expert at operating in an electronic environment.

Nevertheless, the impact of these initiatives is highly speculative, and some have suggested that more fundamental changes to proxy infrastructure may be the best way to increase RBO participation. While a review of potential changes is beyond the scope of this paper, CDV should not be viewed in isolation from the kinds of regulatory developments that could result from the SEC's concept release. Some changes could have significant implications for CDV — both in terms of the need for a CDV model and its design — particularly insofar as they promote transparency in share ownership and more direct communications between companies and shareowners (or among shareowners). The most important of these are proposals that would modify or eliminate the “OBO/NOBO” distinction,²² require securities intermediaries to transfer voting authority to beneficial owners and promote shareowner direct registration in company books and records. Others include changes to SEC rules to require more timely ownership reports by institutional holders and adjustments to the current framework to permit companies to take advantage of state laws that permit separate record dates for determining shareowners entitled to notice of a meeting and to vote at the meeting.²³ Changes that streamline the voting process, such as a system that would permit an RBO to vote at one time his or her entire position in a company — regardless of the number, type or location of the accounts through which it is held — could also facilitate higher rates of RBO participation.

Perspectives on CDV Design

The Basic Tension

CDV aims to resolve the basic tension between what RBOs do — generally not vote — and what commentators and regulators want them to do — vote on an informed basis. Perspectives about bridging this gap through a CDV model differ considerably.

Some commentators argue that the simplicity of revocable advance instructions based on a “for, against, abstain” voting model, without a mirror-voting option, not only has strong user appeal, but substantive grounding based on the following observations:

- RBOs purchase stock because they like the company and its performance and therefore are more likely to support management and avail themselves of the “Wall Street walk” when dissatisfied with stock performance.
- Permitting RBOs to mirror the votes of institutions would be a flawed and potentially misleading approach:
 - Institutional investors do not owe any fiduciary duty to RBOs or to anyone other than their own investors, in contrast to public company directors and officers who must exercise their fiduciary duties in the long-term best interests of their shareowners, and a system that would facilitate (and potentially encourage) mirror-voting is inappropriate as a policy matter;
 - Public company directors would face potential liability if they failed to act in the long-term best interests of their shareowners as they would be in breach of their fiduciary duties, liability institutional investors currently would not face if RBOs chose to follow the institution’s published votes as there is no fiduciary relationship between the RBO and the institution;
 - Institutions often vote differently than their voting guidelines may suggest, which occurs for many undisclosed reasons, such as private communications with the company in question, the relative contentiousness of the issue and the company’s performance; and
 - Investment and other objectives of institutional investors vary widely and the institutions may have interests that are not always apparent from their voting guidelines.
- Historical experience of institutions with proxy advisory firms suggests that a CDV model involving application of third-party voting guidelines or decisions would be problematic, mainly due to the challenges in developing a common coding approach to ensure accurate voting results and a reliable audit trail.
- At least in the first instance, designing a more complex CDV model may be not be justified by the potential benefit, given the likely appeal of CDV to a relatively small segment of RBOs whose time constraints already prevent them from voting based on existing proxy materials.

But other commentators object strongly to this streamlined model because they believe it would operate to produce the same results as uninstructed broker voting. They believe the analogy to institutional investor use of proxy advisory firms is imperfect for at least two reasons. First, in light of their fiduciary duties, institutions must review their voting practices and decisions each year, an obligation not shared by RBOs. Second, institutions have regular means of providing input into the published guidelines of proxy advisory firms and often develop bespoke guidelines in consultation with those firms. This reflects a level of engagement not present with an approach that relies on mirror-voting, particularly where the standing mirror-vote need not be reviewed and reaffirmed on a regular basis.

This group of commentators is therefore focused intensely on the educational challenge presented by efforts to increase RBO participation, as well as requirements that RBOs opt into CDV and reaffirm their instructions periodically. They generally favor CDV models that emphasize information delivery (including posting voting guidelines or decisions on the Internet), as much as streamlined voting mechanics. These commentators are less likely to concede objections to a more complex CDV model based on information overload, given their perception that RBOs generally hold few individual stock positions. More significantly, their perception seems to be that, if information overload or lack of interest would cause an RBO to avoid the burdens of a more complex model, it would be preferable that CDV not operate to facilitate that RBO's vote.

At the same time, this group of commentators acknowledges the efficiency of leveraging the voting resources of institutional investors, although some support the principle that the model should operate as an “aggregator, not an advocater.” Aside from sharing the conceptual and logistical concerns about mirror-voting noted above, these commentators raise a further concern about the potential for unwanted company solicitation if institutions were required to publish voting decisions in advance of meetings. They also generally recognize that some content-based standards may be needed to address concerns about the integrity or transparency of posted voting guidelines and would not rely solely on market forces to expose misleading information or proponents with hidden agendas or conflicts of interest.

Another way of looking at this basic tension is to ask whether RBO voting should be facilitated based on a model analogous to that generally available for purposes of making investments. Like all investors, RBOs may appoint agents to advise or act for them when making investments on an unfettered basis. Those agents are subject to regulation principally directed at precluding fraud, providing disclosure about material matters relating to investment strategy, past results and a number of other matters, and disclosing or precluding conflicts of interests. There is no limit on RBO choice as to how to invest. Applied to voting, a similar model would allow RBOs to choose an agent from among whatever choices are made available, subject to the appropriate regulation of the agent. Constraining the RBO's choices to those that promote informed voting would not be consistent with this approach. While informed investing is encouraged, it is not required.

While appealing on the surface, this concept leaves two important issues unaddressed. First, what would be the appropriate approach to regulation? Disclosure and conflicts of interest would appear to be issues that need to be addressed as we discuss in Part IV. Second, if an investor who has not made informed investment decisions (or whose agent does not) loses money, other investors and the company generally do not suffer the consequences. The same may not be true in the exercise of voting rights insofar as a substantial uninformed vote (or misinformed vote, if the voting mechanism failed to protect against fraud or conflicts of interest) can influence the outcome of a ballot item. While it is not clear how the collective interest of investors should be taken into account, and indeed many of the issues arising from CDV revolve around this point, the existence of that interest should be recognized in evaluating any particular CDV model.

SCSGP Principles

As one of the most active proponents of CDV, the SCSGP has developed general principles to guide its implementation, which are attached as [Annex C](#). The SCSGP principles highlight the central predicates for a CDV model. While they are wide-ranging, the most important in terms of general applicability and regulatory appeal are:

- The primacy of disclosure — participating RBOs should receive no less disclosure and no less timely disclosure than they do today;
- The importance of RBO control over voting preferences — a CDV model should permit RBO override of voting preferences to the same extent as provided by current proxy rules that permit a holder's proxy to be superceded by a proxy given at a later date; and
- The importance of affirmative RBO action — RBOs should opt into a CDV model and periodically reaffirm their participation to promote engagement and avoid creating an approach that replicates the vices of uninstructed broker voting.

In brief, the SCSGP principles imply a CDV model that provides a solution for the time-constrained RBO through the use of pre-set voting preferences on a portfolio-wide basis. They balance the efficiency of advance instructions with ultimate RBO control over the vote eventually cast when required solicitation materials are available. At the same time, while conceding the practical challenge of a more complex system, the SCSGP principles contemplate customized advance instructions “reflecting a broad spectrum of investor viewpoints, . . . which are publicly available or otherwise placed on the platform on acceptable terms.” The SCSGP model for CDV would thus change the dynamics of the current framework by easing the burden of the voting process and facilitating access to informative background materials and, possibly, voting options. This balanced approach is intended to help assure that CDV does not operate simply as an uninformed pro-management default.

Key Features of CDV

Even assuming a consensus around the guiding principles, proposals about the design of some of the key features of CDV vary. These “moving parts” are summarized below.²⁴

- **Scope of proposals covered by CDV.** CDV could apply to all shareowner and management proposals or a subset of common, easily defined proposals, perhaps limited to those that relate to governance.²⁵ Director elections could be included or excluded as a rule, or excluded only in the case of contested elections (including elections subject to “vote no” campaigns). Any other matter for which management and the proponent are using separate proxy cards might also be excluded, as is suggested by the SCSGP principles.
- **Voting choices.** Choices could be simplified — for, against, abstain — or more nuanced, with a menu of options that could include third-party voting guidelines or decisions (or voting feeds), as well as guidelines of proxy advisory firms. An ancillary design question involves treatment of matters for which an RBO has not specified instructions. At least three options are possible. Those votes could be cast on a proportional basis with other instructed RBO votes at the relevant broker or intermediary or they could be treated as not having been voted at all. In the latter case, if the proxy card were appropriately drafted, management could vote at its discretion matters treated as not voted.²⁶ A third option would permit RBOs to select a default voting choice for all matters for which it otherwise has not specified a vote.

Approaches to this feature also depend on whether RBOs are perceived as “company-oriented” or “issue-oriented.” As noted above, some commentators suggest that RBOs predominately invest based on company name and performance and that, if dissatisfied with company performance, are more likely to sell their position rather than seek governance changes. On this basis, they assert that a simple “for, against, abstain” approach is not only adequate, but appropriate. These commentators note the contrast between RBOs and institutional investors, which are effectively bound by their fiduciary duties to be issue-oriented. Other commentators promote an issue-based approach as a more “natural” voting environment if the goal of CDV is informed participation. Of course, the reality is that RBOs are not monolithic and include persons at both extremes and many points in between. Models built for either extreme may be less successful than one that accommodates a range of preferences.

- **Voting decisions versus voting guidelines.** If a menu of decisions or guidelines were made available, RBOs could give advance instructions to align their votes with a selected option. If a voting *decision* were selected, the RBO would vote identically to the selected investor, although timing and confidentiality questions exist given that institutional voting often occurs shortly before voting deadlines.

If an institution’s voting *guidelines* were selected, the intermediary would apply the guidelines to each applicable ballot item to determine how an RBO’s shares should be voted. This approach also presents logistical issues. Guidelines are often susceptible to interpretation, which could make their application contentious or lead to a divergence between the institution’s and RBO’s votes as noted above. Moreover, if an institution’s policies stated that a guideline would be applied on an *ad hoc* basis, there would be no certainty that the votes of the RBO and the institution were aligned unless the institution published its voting decision in advance of the meeting. Voting guidelines also may not cover all of the matters subject to a vote at the annual meetings of the RBO’s portfolio companies, leading some commentators to recommend that RBOs be able to identify two or three choices that operate as defaults in that case.²⁷

- **Scope of participants posting voting guidelines or decisions.** Some have suggested that the universe of investors permitted to post voting guidelines or decisions could be unlimited, but most concede that this approach would raise concerns about systems complexity and information quality. A model that limits posting investors to institutions may address these concerns to some extent, but not fully. Proxy advisory firms could also participate, although some have objected to their inclusion absent greater regulation of their activities.²⁸ Some of these firms publish summaries of their guidelines, but that practice is not universal, and this latter group of firms is unlikely to make voting guidelines they offer to institutions on a fee basis generally accessible to others for free.
- **Scope of advance instructions.** RBOs could give advance instructions generally across all proposals (*e.g.*, vote with management on all proposals) or have the ability to customize their instructions by proposal (*e.g.*, vote with management for proposals regarding right to call a special meeting, but with a specified institution for proposals relating to executive compensation).
- **Frequency of RBO review of advance instructions.** RBOs could be required to renew their advance instructions periodically, failing which the advance instructions would expire. Alternatively, RBOs could themselves set a desired review frequency, with or without an option to “set it and forget it” for permanent advance instructions.
- **Use of pre-marked VIF.** Some, but not all, proponents urge the use of a pre-marked VIF to show the application of an RBO’s advance instructions to the matters subject to vote at the applicable annual meeting. Shares would be voted as marked, absent the RBO’s override. From a regulatory perspective, some view the pre-marked VIF to be an important investor protection feature to the extent that it supports the goal of volitional voting.

The potential advantages and disadvantages of approaches to these features of a CDV model are summarized in the table below.

Feature	Potential Advantages	Potential Disadvantages
Scope of Proposals Subject to CDV		
All management and shareowner proposals	<ul style="list-style-type: none"> ■ Potential for greater RBO participation with respect to more proposals 	<ul style="list-style-type: none"> ■ Advance instructions may not be appropriate for contested proposals in which proponent and management are using separate proxy cards; in those cases, the advocacy may be more nuanced and merit more customized analysis based on the individual circumstances of the company (a particularly acute concern for contested director elections) ■ Potential for information overload that could discourage RBO participation ■ Greater challenge in developing appropriate codes for the range of proposals and their various iterations ■ Other approaches, such as increased solicitation, could produce increased and more informed RBO participation
Subset of common and easily defined proposals (e.g., staggered board; cumulative voting)	<ul style="list-style-type: none"> ■ Easier to engage RBOs, as more user-friendly ■ Less risk that CDV model will operate to marginalize important differences in more sensitive or complex proposals ■ Easier to develop a coding system for these proposals, since they tend not to have multiple variations 	<ul style="list-style-type: none"> ■ Potential challenges in defining universe of proposals that would meet the “easily defined” threshold, particularly given increasingly nuanced shareowner proposals on many “common” governance matters; issue is made more challenging if regulatory intervention were needed to determine this universe of proposals ■ Utility of CDV may decline with exclusion of proposals, given the number of votes that would be subject to <i>ad hoc</i> completion by RBOs ■ Potential for disproportionate development costs to capture the benefit of CDV for a limited subset of proposals ■ Potential for confusion among RBOs who do not appreciate the need for further action on items not covered by advance instructions; this disadvantage would be heightened if uninstructed items are treated as not voted, permitting management to vote those items
Exclude director elections and contested proposals	<ul style="list-style-type: none"> ■ Appropriately reflects need for closer consideration of more sensitive or complex items ■ Potential for greater RBO participation with respect to more proposals 	<ul style="list-style-type: none"> ■ Utility of CDV may decline as more proposals are excluded, given the number of votes that would be subject to <i>ad hoc</i> completion by RBOs ■ Potential for confusion among RBOs who do not appreciate the need for further action on items not covered by advance instructions; this disadvantage would be heightened if uninstructed items are treated as not voted, permitting management to vote those items

Feature	Potential Advantages	Potential Disadvantages
Voting Choices		
For/against/abstain	<ul style="list-style-type: none"> ■ Simple to understand and implement ■ No need to involve intermediary or others to make judgments about application of third-party guidelines to specific proposals 	<ul style="list-style-type: none"> ■ If design did not compel genuine volition in voting, could be viewed as the equivalent of uninstructed broker voting; absence of obligation to reaffirm advance instructions (or an infrequent obligation to do so) could exacerbate this issue ■ Even if structured to ensure volition, could have same effect as uninstructed broker voting
Uninstructed shares voted proportionally	<ul style="list-style-type: none"> ■ Increases voting participation without a “default” vote for management, a claim often asserted against brokers who vote uninstructed shares at their discretion ■ Practicable and used by many brokers within current framework ■ An affirmative selection by RBO of proportional voting represents a valid choice and therefore is not practical equivalent of uninstructed broker voting 	<ul style="list-style-type: none"> ■ Potential equivalent of uninstructed broker voting ■ Potential for manipulation by investors moving share positions in order to influence the investor base used for this purpose
Uninstructed shares treated as not voted	<ul style="list-style-type: none"> ■ Better reflection of reality than proportional voting ■ Avoids challenges of determining which voting base to measure for purposes of casting a proportional vote 	<ul style="list-style-type: none"> ■ Would depress RBO voting participation on uninstructed items ■ Could give management the vote on uninstructed items²⁹
Menu of other investor voting decisions or guidelines	<ul style="list-style-type: none"> ■ Broader array of choices ■ More likely to promote informed voting ■ Less likely to result in perception that CDV is practical equivalent of uninstructed broker voting 	<ul style="list-style-type: none"> ■ Likely to attract fewer RBO users because less user-friendly, given additional complexity ■ More significant implementation questions ■ Potential for information overload may discourage RBO use of this model ■ Because institutions reserve the ability to vote contrary to their own voting guidelines if warranted, RBOs basing advance instructions on institutional guidelines may not in fact vote the same as the relevant institutions on a given item ■ Institutions may prohibit intermediaries from allowing RBOs to mirror their votes, since they do not owe a fiduciary duty to any investors other than their own investors and want to avoid any implication that they have expanded duties, thus limiting voting choices

Feature	Potential Advantages	Potential Disadvantages
Voting Decisions vs. Voting Guidelines		
Voting decisions	<ul style="list-style-type: none"> Allows RBOs to follow other investors and benefit from their expertise Minimizes potential for errors in coding proposals and application of guidelines 	<ul style="list-style-type: none"> Inappropriate to provide incentive to align RBO votes with institutions that owe no fiduciary duty to RBOs; institutions likewise may prohibit explicit mirror-voting for the same reason and to avoid any implication that they have expanded duties, thus limiting voting choices Difficult to process RBO voting instructions if, as is now the case, institutional investors vote close to meeting date Confidential voting procedures impair ability of intermediaries to apply an RBO's vote in the same manner as the selected institution, absent a requirement for institutions to publish their votes
Voting guidelines	<ul style="list-style-type: none"> Institutions may be more willing to allow RBOs to follow their guidelines than decisions 	<ul style="list-style-type: none"> Inappropriate to provide incentive to align RBO votes with institutions that owe no fiduciary duty to RBOs; institutions likewise may prohibit explicit mirror-voting for the same reason and to avoid any implication that they have expanded duties, thus limiting voting choices Particular institutional investors may have interests or concerns that are factors in their guidelines but are not applicable to investors generally and are not apparent from guidelines Investors often reserve discretion to deviate from their guidelines, creating the potential for disparity between the actual institutional vote and the RBO's voting expectation based on the institution's guidelines Impractical to code proposals and accurately apply guidelines to some types of proposals, particularly in light of potential liability Intermediaries not likely to accept responsibility for applying guidelines if any discretion or judgment involved, as will almost always be the case
Scope of Participants Posting Voting Guidelines or Decisions		
Institutional investors only	<ul style="list-style-type: none"> Focuses on that segment of investor community with the greatest interest and resources to develop and advance meaningful voting rationales Leverages the fiduciary duty of many institutions as a proxy for regulation directed at liability for misleading statements 	<ul style="list-style-type: none"> Limits choices and fails to capitalize on the voting "brands" approach that would filter choices as effectively Implicates all issues above regarding use of institutional voting guidelines or decisions
Inclusion of recommendations of proxy advisory firms ³⁰	<ul style="list-style-type: none"> Acknowledges the key role these firms now play in the governance landscape Proxy advisory firms already publish their guidelines, so little cost in making these available to RBOs among voting choices 	<ul style="list-style-type: none"> Proxy advisory firms would not likely make available any information about company-specific voting decisions or other matters that would cannibalize their fee-for-services business model Some constituencies, notably companies, may object to participation by proxy advisory firms in the absence of greater regulation of these firms because of the critical role they play despite their lack of economic interest, perceived conflicts of interest and perceived "one size fits all" approach to governance matters³¹

Feature	Potential Advantages	Potential Disadvantages
Application of Advance Instructions		
Portfolio-wide	<ul style="list-style-type: none"> User-friendly simplicity Simplicity of implementation for intermediaries Lower cost 	<ul style="list-style-type: none"> Uncertainty for RBO as to whether a proxy is voted at all or on every issue on RBO's behalf, but system could become complex if RBOs rank voting choices to address case in which one voting choice does not have a guideline / decision on a matter
By proposal type	<ul style="list-style-type: none"> More natural point of departure if goal is to promote informed voting Increased customization Decreases potential need for RBO override of advance instructions, which could encourage RBO participation insofar as it promotes a "set it and forget it" approach 	<ul style="list-style-type: none"> Could discourage RBO use of CDV since RBOs may not take the time to become informed about individual issues Increased complexity of use for RBOs Potential increased complexity of implementation for intermediaries Potentially greater systems development cost
Reaffirmation of Advance Instructions		
Annual reaffirmation	<ul style="list-style-type: none"> Addresses rapidly changing dynamics of governance proposals and evolution of management and investor perspectives about best practices Promotes more engaged RBO participation 	<ul style="list-style-type: none"> If annual reaffirmation is required, there is less difference between CDV and today's proxy framework calling for annual voting Requires more time and effort from RBOs, which could discourage RBO participation
Periodic, but less frequent than annual reaffirmation	<ul style="list-style-type: none"> Requires less time and effort from RBOs than annual reaffirmation Mitigates potential for CDV to be perceived as practical equivalent of uninstructed broker voting 	<ul style="list-style-type: none"> Any reaffirmation that occurs less frequently than annually could undercut concept that CDV is volitional and increase the concern that it is the practical equivalent of uninstructed broker voting Potentially diminishes RBO engagement in a rapidly changing governance environment
RBO ability to set own reaffirmation preference	<ul style="list-style-type: none"> Allows RBO preferences to drive CDV on a more individualized basis Less intrusive for users 	<ul style="list-style-type: none"> Many RBOs may "set it and forget it," which could be viewed as discouraging informed RBO participation If many RBOs select management as initial default, may be perceived or operate as the practical equivalent of uninstructed broker voting
VIF		
Pre-marked VIF	<ul style="list-style-type: none"> Satisfies investor protection goal since RBO will see how his shares will be voted in the absence of RBO's override User-friendly in terms of clarity and time-savings Does not prevent RBO from overriding votes shown at any time prior to the ordinary course voting deadline 	<ul style="list-style-type: none"> Potentially discourages informed RBO participation if RBOs "set it and forget it" and do not review pre-marked VIFs

Other Regulatory and Logistical Considerations

Aside from the features noted above, the design and acceptance of CDV will be driven by other regulatory and logistical considerations that have been raised by its proponents. We note the most widely raised considerations below. In our view, however, one regulatory concern has not been fully addressed by proponents, and that is whether it is appropriate to permit solicitation of voting instructions in the absence of the disclosures mandated by the SEC's proxy rules. The proxy rules are predicated on the principle that voting should not be decoupled from these disclosures that are intended to provide appropriate context for voting decisions. This principle was most recently reflected in the e-proxy rules, which prohibit the mailing of the proxy card with the Notice of Internet Availability of Proxy Materials.³² CDV proponents address this problem mainly through assertions that institutional investors essentially set advance voting instructions now through their reliance on proxy solicitation firms — an approach, they argue, that is worse than CDV, since those firms have no economic interest in the companies that are the subject of their voting recommendations. But as noted above, the ways that institutions use proxy advisory firms vary significantly and often involve significant year-to-year dialogue about current governance issues. Moreover, that institutional practices may have evolved in this direction does not require, as a matter of policy, that the model be extended to RBOs if that result would be inconsistent with fundamental principles of investor protection. CDV also seeks to address the policy issue from an operational perspective through the revocability of advance instructions, as well as through opt-in and reaffirmation features, but these may not be sufficient to overcome the regulatory concern.

Assuming a favorable resolution of this basic policy issue, it is noteworthy that most commentators believe that a prescriptive regulatory approach by the SEC or other relevant regulators³³ could inhibit the evolution of CDV in line with technological innovation, the competitive landscape among intermediaries, developments in proxy infrastructure and the preferences of RBOs and other participants in the proxy voting process. An approach that removes any current regulatory impediments, such as those arising under Securities Exchange Act (Exchange Act) Rules 14a-3 and 14a-6 discussed below, seems more conducive to providing a development platform for CDV. That approach would likely result in fewer direct and indirect costs and would allow CDV more latitude to develop organically in line with market forces and RBO preferences.

In this regard, and particularly if RBOs must opt into CDV, there seems to be no regulatory justification either to restrict access to particular classes of RBOs based on sophistication or, by the same token, to require that brokers, banks or other interested intermediaries offer the service to all RBOs.³⁴ Nor should the SEC regulate the types of intermediaries — brokers, bank custodians, shareowner forums or others — that may lawfully offer a CDV service, although exemptions from the SEC's solicitation rules and any other conditions to offering a CDV service should apply equally to all of these actors to create a level playing field and promote competition.³⁵ Similarly, a regulatory approach that would specify with granularity the type of institutional voting guidelines or decisions that might be eligible for inclusion in a CDV environment would impair the attractiveness of the model. This type of limitation could impose new compliance costs on institutional investors that would otherwise not object to RBO access to their voting guidelines or decisions.

Paper versus Online Model

Given uncertainty about the costs and RBO acceptance of a CDV model, many suggest that CDV be promoted first in an online environment. The additional burden and cost of a paper-based system are undeniable. In the absence of empirical data about expected CDV adoption rates, an approach that minimizes these burdens by focusing first on a Web-based CDV model seems desirable.³⁶

The Role of Intermediaries

Because most RBOs hold their stock through brokers and bank custodians, some commentators suggest that reliance on these intermediaries would facilitate more rapid CDV adoption by RBOs, as we suggest above. A CDV service would be a natural adjunct, for example, to the Web-based information and trading services that many brokers already offer to their clientele, making the evolution of CDV less dependent on the need for an independent business model.

Reliance on a customer account-centric model (*i.e.*, allowing RBOs access to CDV through their broker-dealers' Web sites) would have the additional advantage of creating a one-stop portal for voting positions without the need to link to and click through another Web-based voting environment. A further advantage is the ability to leverage existing proxy infrastructure, notably the link between the broker's client interface and the principal existing voting platform available through Broadridge. At least one commentator has urged a further step by suggesting that the SEC require intermediaries to direct VIFs to any voting platform specified by an RBO, much as beneficial owners may now specify a physical or email address for delivery of proxy materials.³⁷ Since other shareowner-focused Web sites can access the Broadridge voting platform on a fee basis, this additional feature could promote CDV adoption and competition in refining and improving the service.

While reliance on broker and bank intermediaries has many proponents, it is clear that the intermediary's role must be a passive one. Brokers and banks are unlikely to accept responsibilities, such as applying third-party voting guidelines or decisions to RBO voting instructions, particularly if they cannot recoup the cost of doing so or if these responsibilities entail liability exposure beyond existing standards of care.³⁸ The same goes for other actors in a CDV model, such as operators of voting platforms. We are also skeptical that brokers and banks would be willing to develop a menu of voting options or in-house governance research capabilities, which could entail unrecoverable costs. That said, brokers and banks that sponsor their own investment funds now develop voting policies that could be readily adapted as "house" guidelines.

SEC action would be required to clarify the application of the proxy solicitation rules to intermediary participation in CDV. Rule 14a-1(l) under the Exchange Act defines solicitation to include the "furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy," subject to certain exceptions. Communications sent by brokers to encourage participation in a CDV model would appear to fall within this definition absent an exemption, and the SEC staff agrees with this conclusion.³⁹ As such, brokers would have to comply with the proxy solicitation rules, including principally the disclosure and SEC filing requirements applicable to proxy materials.⁴⁰

Exchange Act Rule 14a-2 provides additional guidance on the application of the SEC's proxy rules and provides an exception for communications from brokers to beneficial owners that seek voting instructions and do not influence the manner in which the beneficial owner votes are exempt from the SEC's solicitation rules.⁴¹ While soliciting participation via a CDV model has a similar purpose, the second condition to the exemption may be problematic for communications that seek advance instructions, since it requires that the beneficial owner promptly be given copies of all soliciting material

relevant to the same subject matter for which the broker is seeking instructions. In its request for interpretive guidance, the SCSGP has argued that this requirement would be satisfied in a CDV model since no votes are in fact tabulated until after the soliciting materials are received.⁴² The SEC staff does not agree with this position; in its view, the solicitation of advance voting instructions by definition does not satisfy the requirement that the intermediary “promptly furnish” proxy materials.⁴³ If the SEC were to revise this condition to facilitate CDV, there are several compensating steps that it could take. These include requirements, among others, to (1) pair advance instructions with cautionary disclosure that the instructions will relate to existing and future portfolio positions and to matters about which mandated solicitation materials are not yet available; and (2) deliver to CDV participants a pre-marked VIF (the practicality of which will depend on the complexity of the voting choices) that specifically calls out the ability of the RBO to override previously-set advance instructions on any matter.

Information Provided to RBOs

One rationale for advancing CDV is to provide RBOs with a window into the more robust dialogue about governance that now occurs between management, directors and many institutional investors representing a wide variety of economic and social perspectives. While this rationale is appealing, some commentators question whether it is the responsibility of regulators to facilitate “comparison shopping” among voter opinions on ballot items. Even among those who accept this rationale and concede a role for the SEC in facilitating CDV, many acknowledge that the quality, form, clarity, simplicity and timing and accessibility of information about proxy voting will significantly influence both the likelihood and degree of RBO engagement. Because small changes in how information is presented can have a disproportionate impact on ease of use, careful planning of these features will be central to the potential effectiveness and consequences of CDV.

Commentators generally agree that inclusion of voting guidelines or decisions in a CDV service should be voluntary on the part of the relevant institutional investor.⁴⁴ Aside from that point of consensus, several questions remain, including:

- Whether it should be permissible to post voting guidelines in the form in which the institutional investor publishes them generally or whether content-based standards would be appropriate;
- The nature of content-based standards that may be applied. For example, an institutional investor might be obligated to disclose, at a minimum, (1) what it is (*e.g.*, a proxy advisory firm, an investment fund oriented to socially responsible investments or a federation of labor unions); (2) its investment strategy and how that may drive its voting policies, (3) its process for determining a voting position (*e.g.*, use of a fiduciary based on independent research; outsourcing to a proxy advisory firm); (4) material conflicts of interest (*e.g.*, related person transactions); and (5) its lack of fiduciary duties to anyone other than its own investors and the fact that actual votes may vary from the positions set out in the guidelines for reasons that the institution is not obligated to disclose. Commentators have suggested that content-based standards should be limited in number and kind to promote accessibility of these guidelines as an informational tool for RBOs and, in particular, should not impose liability standards beyond those that may apply under existing law;⁴⁵
- Whether institutions that volunteer their voting guidelines for inclusion in a CDV service should be subject to mandatory reporting of their actual votes so that RBOs have a basis for understanding how the guidelines are actually applied;
- The appropriateness of other limitations (*e.g.*, size of investor or resources devoted to voting and governance analysis in connection with its investments) as a proxy for the quality or integrity of the guidelines;

- Whether intermediaries that act as aggregators of voting guidelines could adopt their own screening tools or otherwise limit the number or types of voting perspectives represented or should be required to present a range of perspectives; and
- Whether the availability of this information detracts from focus on the SEC-mandated proxy disclosures and whether there are steps the SEC could take to make those disclosures more likely to be read.

While there is no consensus on the approach to these questions, how they are handled will affect not only the design of CDV, but also the willingness of institutions to post their voting guidelines or decisions in a CDV service. It seems axiomatic that any CDV model that calls for increased regulation of the content or timing of publication of voting guidelines or decisions will reduce the willingness of institutions to participate.

Data Tagging and Audit Trail

One common concern raised about CDV relates to the need to code both proposals and, to the extent the model contemplates mirror-voting, specific voting guidelines or decisions in order to facilitate the operation of the model in an online environment. Coding errors in today's framework occur, although there is no publicly available empirical data that measures error type or frequency. Errors in reporting votes and confirming tabulation could be expected to increase with the complexity of the CDV model, which could in turn affect the availability and integrity of the audit trail for a given vote. While other matters more significantly affect the audit trail (*e.g.*, over- and under-voting) and may be addressed in the wake of the concept release, a CDV model should take into account tools to reduce errors in voting and tabulation.⁴⁶ Many commentators have suggested that this concern could be addressed in part through standardized data tagging by analogy to XBRL data tagging of financial statements.⁴⁷

Cost Considerations

We are not aware of any survey or other attempt to identify and quantify costs that would be incurred by the principal interested constituencies (e.g., companies, intermediaries (whether brokers, banks or shareowner forums and voting platforms)) to develop and maintain a CDV model. CDV start-up costs would include the costs in systems development for the CDV platform, the costs of populating any menu or library of voting guidelines or decisions, as well as costs associated with enrolling RBOs and educating them about the system. Ongoing costs would include, at minimum, database and systems maintenance costs and costs associated with preparation of pre-marked VIFs. There could be indirect costs associated with legal compliance, depending on the approach taken by the SEC and other regulators, whether specifically with respect to CDV or more generally with respect to matters affecting proxy infrastructure.

These costs could be significant, although in the case of some of them, notably systems development, intermediaries have developed and gained experience operating similar products (e.g., Broadridge's institutional ProxyEdge product) that could be leveraged to curb costs. The cost of promoting CDV could, however, be considerable, if experience with Internet delivery of proxy materials is a guide. In the case of that precursor of e-proxy, invitations to shareowners are ubiquitous, but have generated relatively limited interest given the size of the overall voting population. If CDV is promoted via brokers and bank custodians as a readily-added ancillary service for existing online account holders and for persons opening new accounts, these expenses may be mitigated somewhat even if participation requires affirmative action by RBOs.

Literature promoting CDV has not focused on cost allocation. Some have speculated that cost savings to companies using e-proxy would be an ample offset to CDV development costs. Those commentators also point to existing NYSE rules that require companies to bear the principal cost of the current voting framework.⁴⁸ It is unclear whether this approach could be appropriately adapted for an online CDV service and, in any event, it has been subject to significant objections from the business community since pricing is fixed.⁴⁹ If history is any indication, cost allocation could be an impediment to further development of a CDV model: The SEC had to defer the effective date of the rules governing the current voting framework for two years while companies and intermediaries debated cost allocation.⁵⁰

Conclusion and Recommendations

In any assessment of CDV, the central question is the problem the model is intended to address. While a broad consensus exists about the importance of RBO participation, open questions remain about the appropriate — and reasonably practicable — goals that CDV should serve. A key operational question is whether to permit RBOs to benefit indirectly from the resources that institutional investors devote to the annual meeting process and, if so, how to address the many substantive and logistical issues that would ensue. In this sense, no iteration of CDV persuasively addresses the core problem, which is one of investor education — convincing RBOs of the importance of their vote.

Design considerations aside, CDV presents a fundamental policy issue for the SEC. Under any CDV model, RBOs would set voting instructions before disclosure about the matters in question is available and before the specific matters are known — indeed, in some iterations of CDV, before the shareowner even owns stock in a company for whose annual meeting the instructions would apply. This is in stark contrast to the core objective of the current proxy framework that does not permit voting in the absence of highly detailed disclosures because of the high value the SEC places on making sure investors have an opportunity to understand the matters on which they are asked to vote. As a matter of public policy, it is far from clear how the SEC will balance the independent value it ascribes to RBO participation — apparent from the commissioners' remarks at the open meeting for the concept release⁵¹ — against the disclosure and investor protection principles underpinning the current framework. The SEC must also evaluate whether the features of CDV intended to address this concern — the ability to revoke advance instructions and periodic reaffirmation of advance instructions — are sufficient.⁵²

That said, we acknowledge other policy considerations that support continued development of a CDV model, notably the SEC's interest in promoting a level playing field among institutional investors and RBOs. In this regard, we note that institutional reliance on voting guidelines may be a form of advance revocable voting instructions. We also note the concerns raised by many about the extent of the reliance by institutions on proxy advisory services, although there is no firm evidence about institutional practices in this regard. Some institutional investors may effectively “outsource” their voting function to proxy advisory firms due to staffing or other constraints, but many others (particularly larger institutions with greater financial and staffing resources) use proxy advisory services only as a supplemental resource. We also recognize that some features of the current proxy voting system may now operate to marginalize RBO participation.⁵³ They include the length of proxy materials, the design of the VIF and the delivery mode that companies may select for their proxy materials.

CDV clearly merits consideration as part of the evaluation of proxy infrastructure that is ongoing and, with the publication of the concept release, will now intensify. The questions the SEC has raised in the concept release ensure that interested constituencies will have the chance to express their perspectives about the basic tension that underpins the debate today. Given the lack of empirical data on how CDV would work and whether and to what degree it may achieve any particular goals, we anticipate that much of the discussion will be theoretical and therefore potentially contribute to further reluctance on the part of the SEC to take the necessary steps to facilitate CDV. Indeed, at the SEC open meeting to approve the concept release, Commissioners Aguilar and Walter highlighted the importance of fact-finding to its consideration of further regulatory action.

The complexity of CDV and the policy and regulatory issues it entails suggest to us that a robust CDV model is likely to have a long gestation period. This is particularly the case since any CDV model must be considered in light of the wide range of proxy infrastructure questions that the SEC is now raising. Many of these questions may involve regulatory changes that may be more expeditious and, possibly, more effective tools to increase RBO participation. These include improving the potential for direct communications by companies and their shareowners, which could be accomplished through the elimination or adjustment of the OBO/NOBO framework to favor disclosure of shareowner identities, at least

for some period around key shareowner meetings. Other more mechanical adjustments to the current framework that facilitate voting generally should also accrue to the benefit of RBOs. The SEC's focus on more robust broker-dealer online platforms also seems to be a promising tool for increasing RBO engagement. For companies using e-proxy, the SEC could also simply reverse its earlier position and permit companies to provide the proxy card with the Notice of Internet Availability of Proxy Materials and permit shareowners to vote immediately. While this last approach does little in the way of educating shareowners, it has the virtue of being a solicitation conducted at a time when mandated proxy materials are available. This approach attracted criticism when previously considered by the SEC,⁵⁴ and it is not clear that critics could be persuaded that it is any more desirable in today's environment.

While we support continuing examination of CDV, these additional means of promoting RBO engagement seem to us to merit priority consideration. They have the potential to both simplify the voting framework generally and enhance communications in ways that serve the interests of companies and investors alike, leveling the playing field with less potential to skew voting incentives and outcomes. Perhaps more importantly, at least some of these reforms can be achieved — in contrast to CDV — in a way that does not require consideration of investor protection principles underpinning the SEC's proxy rules.

Endnotes

- ¹ We use the term “RBO” to refer to all retail investors, whether they hold through brokers or other intermediaries (*i.e.*, in “street name”) or are direct registered holders in a company’s share registry, and our discussion is limited to use of CDV in connection with non-investment company investments.
- ² See Section 957 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
- ³ SEC Rel. No. 34-62495 (July 14, 2010), *available at* <http://www.sec.gov/rules/concept/2010/34-62495.pdf>. Excerpted portions from the concept release relating to CDV are attached as Annex A.
- ⁴ Although RBOs hold about 30 percent of U.S. public company shares, including mutual funds, RBO participation is not at a comparable level. Historically, less than half of RBOs participate, and even fewer do so when companies use the “notice-only” method for delivery of proxy materials (e-proxy), an approach adopted by the SEC in 2007. See SEC Rel. No. 34-56135 (July 26, 2007). Whereas 20 percent of RBOs provided voting instructions prior to the advent of e-proxy, only about 4.5 percent now do so when e-proxy is used. Broadridge, Notice and Access — Statistical Overview of Use with Beneficial Owners (June 30, 2010), *available at* http://www.broadridge.com/notice-and-access/FY10_full_year.pdf (Broadridge 2010 Statistics); SEC Rel. No. 33-9073, Comment File, Letter from Robert Schifellite, Broadridge, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Nov. 23, 2009) (Schifellite Letter). Voting rates are much higher for investors receiving proxy materials under the “full-set” option, in which hard copy of a company’s proxy materials are provided to shareowners. According to the Broadridge 2010 Statistics, by mid-2010, companies using e-proxy accounted for more than 80 percent all RBO accounts, with e-proxy having been adopted by mid-2010 by almost 58 percent of companies with 300,000 or more beneficial shareowners.

According to data compiled by Broadridge, the average mix of retail / institutional ownership among all U.S. companies is 30 percent / 70 percent, although among the largest 2,000 companies, the mix changes to approximately 20 percent / 80 percent. Some companies do not fit this latter profile, notably legacy mutual institutions such as insurance companies, and mutual funds and small and mid-cap companies tend to be largely retail-held. At least one commentator has characterized the current framework as having created “a tiered system of corporate voting that is correlated with the composition of a company’s shareholder base.” Kenneth L. Altman, *Practical Solutions to Improve the Proxy Voting System* (Oct. 21, 2009) (Altman).
- ⁵ See, *e.g.*, SEC Rel. No. 34-59464, Comment File, Letter from Robert M. Stanton to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Mar. 25, 2009).
- ⁶ See Altman, *supra* note 4. Altman notes in particular that the voting instruction form “does not ‘feel’ as if it has come from the actual corporate issuer, is not user-friendly, and is not the form that is actually filed with the SEC.”
- ⁷ See, *e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J. Law & Econ. 395 (1983).
- ⁸ In addition to state law fiduciary duty obligations applicable to investment managers, the high level of institutional voting participation has been largely driven by two developments. Since 1988, pension funds under the jurisdiction of the Department of Labor have been required not only to vote their shares, but to do so consistent with the “prudent man” standard. See Interpretive Bulletin Relating to Exercise of Shareholder Rights, 29 C.F.R. § 2509.08-2 (2008), *available at* <http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=21630&AgencyId=8>; Letter from U.S. Dep’t of Labor to Robert A.G. Monks, Institutional Shareholder Services, Inc., (Jan. 23, 1990); Letter from U.S. Dep’t of Labor to Helmuth Fandl, Chairman of Retirement Board, Avon Products, Inc. (Feb. 23, 1988). Second, in 2003, the SEC’s Division of Investment Management issued similar guidance requiring investment managers to vote all shares of portfolio companies consistent with the fiduciary duties of care and loyalty. 17 C.F.R. § 275.206(4)-6; 17 C.F.R. § 275.204-2; *see also* SEC Rel. No. IA-2106, 68 Fed. Reg. 6585 (Feb. 7, 2003). Both are regularly cited as responsible for the significant growth in institutional voting participation, the power of proxy advisory firms in the U.S. market and, as an incident, waning support for management’s recommendations. See, *e.g.*, Latham & Watkins, *Corporate Governance Commentary: The Parallel Universes of Institutional Investing and Institutional Voting* (March 2010), *available at* http://www.lw.com/upload/pubContent/_pdf/pub3446_1.pdf.
- ⁹ We do not suggest that the mere designation of advance instructions makes users “uninformed,” but that a design featuring opt-in participation, periodic reaffirmation of instructions and access to issues-based context could be more likely to promote informed voting.
- ¹⁰ See ADDENDUM TO REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE 4-6 (2007), *available at* http://www.nyse.com/pdfs/proxy_working_group08272007.pdf (PWG Addendum). Release No. 34-60215, <http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf> (July 2009). While meeting quorum requirements was originally a principal concern, it no longer drives the dialogue about CDV.

- ¹¹ See Letter from David W. Smith, SCSGP, to Thomas Kim, Chief Counsel, Div. of Corp. Fin., Sec. & Exch. Comm'n (Aug. 7, 2009) (response to SEC questions about the SCSGP's initial request for interpretive guidance). The request for interpretive guidance was later withdrawn. The SCSGP is a professional association, whose member responsibilities include supporting the work of corporate boards of directors, their committees and executive management regarding corporate governance and disclosure.
- ¹² John Wilcox, *Fixing the Problems with Client Directed Voting*, Harvard Law School Forum on Corporate Governance and Financial Regulation (March 5, 2010), available at <http://blogs.law.harvard.edu/corpgov/2010/03/05/fixing-the-problems-with-client-directed-voting/>.
- ¹³ Voting feeds could include both decisions and accompanying explanations; investors could "remix" those feeds with their own views and create a new voting feed.
- ¹⁴ Mark Latham, *Proxy Voting Brand Competition*, 5 J. of Investment Mgmt. 79 (First Quarter 2007).
- ¹⁵ See David Bogoslaw, *Proxy Voting Made Easy*, Bloomberg Businessweek (Feb. 10, 2010), available at http://www.businessweek.com/investor/content/feb2010/pi20100210_927279.htm. As of February 10, 2010, 21 organizations were identified as advocates on MoxyVote. As part of the default voting on MoxyVote, shareowners can rank advocates (to date, mainly socially responsible investor groups that have submitted proposals) to increase the likelihood that a shareowner's selected advocates have posted an opinion on a particular proposal. Shareowners also may set a default of "for, against, abstain" in the event none of the selected advocates posted an opinion. Shareowners can vote through MoxyVote using the control number on their proxy statements either for individual ballots or by having their brokerage automatically direct ballots on stocks they own to MoxyVote.
- ¹⁶ For example, achieving a certain percentage of the vote, even if not succeeding in achieving 50 percent (or a necessary super-majority for some matters), can in some cases be viewed as an important barometer of "success" or "failure" by parties on both sides of a ballot item. One might expect that increased RBO participation would be sought in at least some of these cases. At least one proxy solicitor reports that "a significant percentage of [non-objecting beneficial owners] contacted by telephone because they have not yet voted their shares for a particular company's meeting do then take the time to vote their shares." See Altman, *supra* note 4.
- ¹⁷ The SEC has recognized that RBOs often use their broker's Web site as "one-stop shopping" for their investment needs. See concept release, *supra* note 3, at 80. In the concept release, the SEC is also seeking comment on ways to enhance brokers' Internet platform, including by allowing RBOs to receive notice of upcoming votes and to access proxy materials and VIFs through the customer page on brokers' Web sites. See *id.*, at 80-81.
- ¹⁸ See Rel. Nos. 33-9108, 34-61560, IC-29131, Amendments to Rules Requiring Internet Availability of Proxy Materials (Feb. 22, 2010), available at <http://www.sec.gov/rules/final/2010/33-9108.pdf>.
- ¹⁹ SEC, SEC Adopts Proxy Rule Amendments Encouraging Electronic Shareholder Forums (Nov. 28, 2007), available at <http://www.sec.gov/news/press/2007/2007-247.htm>. Companies have been slow to embrace e-forums, however. See, e.g., concept release, *supra* note 3, at 87; Reuters, *Companies shrug off shareholder e-forum idea* (May 16, 2008), available at http://www.shareholderforum.com/Reference/20080516_Reuters.htm.
- ²⁰ For example, the SEC has created a new "Spotlight on Proxy Matters" page on its Web site that explains proxy voting. See <http://www.sec.gov/spotlight/proxymatters.shtml>. A link to this page is available directly from proxyvote.com, one of the primary online proxy voting services. The SEC reports that investor education efforts have yielded more than 25,000 unique visits to this page and 1,430 references on Google. See concept release, *supra* note 3, at 79.
- ²¹ Aside from CDV, the SEC is seeking comment on other methods to increase RBO participation. See concept release, *supra* note 3, at 78-96. These include (i) ways to improve investor education efforts, including placing education materials on company Web sites and customer pages on broker Web sites; (ii) whether RBOs should receive notice of upcoming proxy votes and have access to proxy materials through broker Web sites; (iii) whether further steps should be taken to facilitate e-forums and other shareowner-to-shareowner communications; and (iv) whether e-proxy should be revised to reflect a stratified delivery approach whereby RBOs would receive "full set delivery" and to permit a proxy card or VIF to accompany the required Notice of the Internet Availability of Proxy Materials. See *id.*

²² This distinction refers to the ability of beneficial owners to object to the sharing of their names with a company under the SEC's current shareowner communication rules. Shareowners who object are referred to as OBOs, and those who do not are referred to as non-objecting beneficial owners, or NOBOs. For a description of the challenges faced by companies conducting a solicitation under the current framework and an alternative "all beneficial owner" model whereby companies could request all shareowner names and positions in connection with certain corporate actions, see Altman, *supra* note 4. For a description of the OBO/NOBO framework under existing law, see Council of Institutional Investors, *The OBO-NOBO Distinction in Beneficial Ownership: Implications for Shareowner Communications and Voting* (Feb. 2010). The SEC is seeking comment on a wide-range of potential reforms relating to the OBO/NOBO framework, including the elimination of the distinction; modifications to the system, such as setting OBO or NOBO as the default and better disclosure about the consequences of selecting OBO or NOBO; and a requirement that securities intermediaries transfer proxy voting authority to beneficial owners. See concept release, *supra* note 3, at 64–78.

With greater ability to communicate with shareowners — even while relying on the voting platforms offered by intermediaries — companies could also engage in other creative approaches to increase voting rates and promote RBO interest in the annual meeting process. Prudential Financial Inc. experimented with voting incentives in the 2010 proxy season, offering to all voting shareowners either an eco-tote or to plant a tree in honor of the voting shareowner, an approach that proved successful in raising RBO participation. See Press Release, *Prudential Newsroom, Prudential Financial is Taking a Novel Approach to Encouraging Proxy Voting* (March 1, 2010), available at http://www.news.prudential.com/article_display.cfm?article_id=5656. It is worth noting that Prudential Financial Inc. has a significant base of directly registered shareowners, meaning that the incentive rewards could be sent directly from Prudential to shareowners, significantly reducing the costs of implementing such a voting incentive program.

²³ See, e.g., Section 213 of the Delaware General Corporation Law (2010). The concept release seeks comment on these issues as well. See concept release, *supra* note 3, at 127–137.

²⁴ The SEC is seeking comment on some features not discussed in this paper, including whether advance instructions should be reaffirmed each time an RBO purchases additional shares of a company's stock for which the relevant RBO has already submitted voting instructions and whether advance instructions could be provided on a company-by-company basis. See concept release, *supra* note 3, at 85. Commentators have generally agreed that establishing advance instructions with each purchase of stock would be unworkable and that, to ease systems design, advance instructions should apply on a portfolio-wide basis.

²⁵ Greater proposal coverage could entail increased systems complexity and cost. A more centralized approach that limits the potential entrants into the CDV market may be better positioned to maximize economies of scale. Whether a more centralized approach or one that relies on competition among Web sites that offer different combinations of varying features would be more effective at increasing RBO participation is a matter for debate.

²⁶ The scope of proposals included in a CDV model could have consequences for voting results. On the one hand, the inclusion of a proposal in CDV could increase RBO voting on that proposal. On the other hand, if the RBO does not take action on other proposals on the ballot that are not covered by CDV, management could vote those proposals in its discretion. See 17 C.F.R. § 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 type how it is intended to vote the shares represented by the proxy in each such case.") This treatment has provoked opposition from some quarters and was among the matters about which the SEC sought public comment in its most recent proxy access proposal. See, e.g., James McRitchie, Request for rulemaking to amend Rule 14a-4(b)(1) under the Securities Exchange Act of 1934 to prohibit conferring discretionary authority to issuers with respect to non-votes on the voter information form or proxy, No. 4-583 (May 15, 2009), available at <http://corpgov.net/wordpress/wp-content/uploads/2010/04/SECpetitionOnBlankVotes.pdf>.

²⁷ MoxyVote now offers this type of feature. See *supra* note 15.

²⁸ See *infra* note 31 and accompanying text.

²⁹ See 17 C.F.R. 240.14a-4(b)(1) and *supra* note 26.

³⁰ At least one commentator has proposed company-specific proxy advisers selected by shareowners to provide with voting recommendations on governance matters, funded by companies themselves. See Latham, *supra* note 14. It is unclear how this additional voice might improve the dialogue on governance issues or increase the quality of RBO engagement, since the arguments on both sides of common governance matters are well rehearsed by existing participants in the process. Nor would this approach, which is in part designed to address management conflicts of interest, avoid all potential for conflicts, since the proposed funding source would be the company itself.

- ³¹ Other criticisms levied against proxy advisory firms include their lack of transparency, faulty analysis and errors in factual analysis. See, e.g., Tamara C. Belinfanti, *The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control*, 14 Stan. J.L. Bus. & Fin. 384 (2009); Society of Corporate Secretaries & Governance Professionals & National Investor Relations Institute, *Proxy Advisory Services: The Need for More Regulatory Oversight and Transparency*, (Mar. 4, 2010), available at <http://www.niri.org/Main-Menu-Category/advocate/Regulatory-Positions/Proxy-Advisory-Services.aspx>. These concerns were also acknowledged by the SEC in the concept release. See concept release, *supra* note 3, at 105–126.
- ³² See SEC Rel. No. 34-56135 (July 26, 2007) (“An issuer may not send a paper or e-mail proxy card to a shareholder until 10 calendar days or more after the date it sent the Notice to the shareholder, unless the proxy card is accompanied or preceded by a copy of the proxy statement and any annual report, if required, to security holders sent via the same medium.”). The Council of Institutional Investors has expressed a similar concern. See SEC Rel. No. 34-55147, Comment File, Letter from Cambria Allen, Council of Institutional Investors, to Nancy M. Morris, Sec’y, Sec. & Exch. Comm’n (Mar. 30, 2007) (CII Letter).
- ³³ Other potential interested regulators include the Financial Industry Regulatory Authority, or FINRA, and the national securities exchanges, although their interests will be significantly more limited than those of the SEC and we do not address them here.
- ³⁴ If a broker were to charge a separate, “clearly definable” fee for a CDV service, it could be subject to registration as an investment adviser under the Investment Advisers Act of 1940. See *American Capital Financial Services, Inc.* (Apr. 29, 1985). Inclusion of a CDV service in a suite of products at a bundled rate would not likely raise this concern.
- ³⁵ These conclusions are also supported by the SCSGP principles.
- ³⁶ The SCSGP principles also reach this conclusion (“offering CDV to paper-based customers will be reviewed as a second step”).
- ³⁷ SEC Rel. No. 33-9073, Comment File, Letter from Larry Eiben, MoxyVote, to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Nov. 19, 2009).
- ³⁸ See NYSE Rules, Rule 2010 *et seq.*
- ³⁹ See 17 C.F.R. § 240.14a-1(l) (2009). See Smith, *supra* note 11. By contrast, public communications by an institutional investor of voting guidelines or intentions are excepted from the definition, so long as the investor is not otherwise engaged in a non-exempt proxy solicitation. Exchange Act Rule 14a-1(1)(2)(iv). The rule also excludes from the definition of “solicitation” communications by security holders not otherwise engaged in a non-exempt solicitation to persons to whom they owe a fiduciary duty in connection with voting securities of a portfolio company or that are in response to an unsolicited request for additional information with respect to a prior exempt communication under clause (iv).
- ⁴⁰ See 17 C.F.R. §§ 240.14a-3 and 240.14a-6.
- ⁴¹ See 17 C.F.R. § 240.14a-2(a)(1). The relevant portion of the rule reads as follows:
- “(a) Rules 14a-3 to 14a-15 do not apply to the following:
- (1) Any solicitation by a person in respect to securities carried in his name or in the name of his nominee (otherwise than as voting trustee) or held in his custody, if such person-
- (i) Receives no commission or remuneration for such solicitation, directly or indirectly, other than reimbursement of reasonable expenses,
- (ii) Furnishes promptly to the person solicited (or such person’s household in accordance with Rule 14a-3(e)(1)) a copy of all soliciting material with respect to the same subject matter or meeting received from all persons who shall furnish copies thereof for such purpose and who shall, if requested, defray the reasonable expenses to be incurred in forwarding such material, and
- (iii) In addition, does no more than impartially instruct the person solicited to forward a proxy to the person, if any, to whom the person solicited desires to give a proxy, or impartially request from the person solicited instructions as to the authority to be conferred by the proxy and state that a proxy will be given if no instructions are received by a certain date.”
- ⁴² See Smith, *supra* note 11.
- ⁴³ See concept release, *supra* note 3, at 84.

- ⁴⁴ Under existing law, disclosure about voting practices and decisions is generally not mandatory. Only mutual funds must now publish information about their proxy votes cast relating to portfolio securities, as well as the policies and procedures used to determine how to vote proxies. See 17 C.F.R. § 270.30b1-4; see also SEC Rel. Nos. 33-8188, 34-47304, IC-25922 (Jan. 31, 2003), available at <http://www.sec.gov/rules/final/33-8188.htm>; SEC, Mutual Fund Proxy Voting Records and Policies (last visited July 13, 2010), available at <http://www.sec.gov/investor/pubs/mfproxyvoting.htm>. Mutual funds must publish their votes in an annual filing on Form N-PX by August 31 of each year. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act, *supra* note 2, institutional investment managers subject to Section 13(f) of the Exchange Act are also required to disclose their voting records on “say-on-pay” and “say-on-golden parachute” votes at least annually, unless otherwise required by SEC rules.
- ⁴⁵ Online forums presented similar concerns prior to SEC regulation that largely exempted participants from liability based on their participation. See SEC Rel. No. 34-57172 (Feb. 25, 2008). The SEC has explicitly exempted statements made in online forums from most solicitation rules, so long as the statements are made outside certain time periods. See 17 C.F.R. § 240.14a-2. The SEC also clarified that a shareowner, company, or third party acting on either’s behalf who creates or runs a forum is not liable for statements made by participants. See 17 C.F.R. § 240.14a-17. Participants retain liability for their statements under anti-fraud provisions, including Section 17(a) of the Securities Act of 1933 and Sections 10(b) and 20(e) of the Exchange Act, as well as Exchange Act Rules 10b-5 and 14a-9. SEC Rel. No. 34-57172 (Feb. 25, 2008).
- ⁴⁶ For the concept release’s discussion of over-voting, see *supra* note 3, at 26-38, and for its discussion of audit trails, see *supra* note 3, at 38-43.
- ⁴⁷ In the concept release, the SEC requests comment on the use of data tagging of proxy statement information to facilitate informed voting, but did not raise the prospect of using this tool to facilitate vote confirmation.
- ⁴⁸ See NYSE Rule 451 Supplementary Material and Rule 465 Supplementary Material.
- ⁴⁹ The current approach is also now part of the SEC’s focus. See concept release, *supra* note 3, at 56-63. Any form of CDV that would require companies to pay subscription fees for proxy advisory services on behalf of RBOs would surely meet with strong objections from the business community.
- ⁵⁰ See Facilitating Shareholder Communications, SEC Release No. 34-22533, at 2 [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,930 (Oct. 15, 1985).
- ⁵¹ See also Mary Schapiro, Chairman, Sec. & Exch. Comm’n, Remarks at the Stanford University Law School Directors College (June 20, 2010) (“And, in an area very near to my heart, how can we increase voter participation by retail investors?”), available at <http://www.sec.gov/news/speech/2010/spch062010mls.htm>.
- ⁵² See concept release, *supra* note 3, at 83 (noting that the SEC had raised concerns and questions about advance voting instructions in its order approving amendments to NYSE Rule 452, including that such instructions require investors to make voting decisions in advance of receiving a proxy statement).
- ⁵³ See also Kathleen L. Casey, Comm., Sec. & Exch. Comm’n, Statement at Open Meeting on Proxy Mechanics Concept Release (July 14, 2010) (“In particular, our recent rulemakings and proposals, while seeking to empower shareholders, would act, in my view, to empower only the ‘right’ shareholders — institutional investors, labor unions and public pension funds — to the detriment of retail shareholders.”).
- ⁵⁴ See, e.g., CII Letter, *supra* note 32.

Excerpts from SEC Concept Release Relating to CDV (Excluding Notes)

IV. Communication and Shareholder Participation

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B. Means to Facilitate Retail Investor Participation

1. Background

As we seek to promote and facilitate shareholder voting in general, we understand that the level of voting by retail investors is a particular area of concern. Retail investor participation rates in the proxy voting process historically have been low. Given the importance of proxy voting, we view significant lack of participation by retail investors in proxy voting as a source of concern, even in companies in which retail share ownership represents a relatively small portion of total voting power. We understand that this situation is not limited to the U.S., as the level of voting by shareholders in other jurisdictions has also caused concern.

2. Potential Regulatory Responses

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c. Advance Voting Instructions

Some commentators have recommended that we adopt rules to facilitate what has been called “client-directed voting” as a means to increase investor participation in the voting process. In general, this concept contemplates that brokers or other parties would solicit voting instructions from retail investors on particular topics (*e.g.*, election of directors, ratification of auditors, approval of equity compensation plans, action on shareholder proposals) in advance of their receiving the proxy materials from companies. The advance voting instructions would then be applied to proxy cards or VIFs related to the investors’ securities holdings, unless the investors changed those instructions. Investors would be able (but not required) to instruct their securities intermediaries or other parties to vote their shares in any number of ways, including the following:

- Vote shares in accordance with the board of directors’ recommendations;
- Vote shares against the board of directors’ recommendations;
- Vote shares related to particular types of proposals (for example, shareholder proposals related to environmental or social issues) consistent with recommendations issued by specified interest groups, proxy advisory firms, investors, or voting policies;
- Abstain from voting shares; or
- Vote shares proportionally with the brokerage firm’s customers’ instructed votes, or the instructed votes of its institutional or retail customers only.

The investors would generally give the advance voting instructions at the time they sign their brokerage agreements or sign up for the proxy voting service, or periodically thereafter, and would always be revocable. Investors would also be able to change the advance voting instructions at any time.

In connection with each proxy solicitation, investors who had given advance voting instructions would receive a proxy card or VIF pre-marked in accordance with those voting instructions, along with the proxy materials required by the federal securities laws. Investors could override any of the advanced voting instructions applicable to that proxy solicitation by checking or clicking on an appropriate election box before the vote is submitted. Absent instructions to the contrary, the securities intermediary or other party would vote the investor's shares in accordance with the advance voting instructions as pre-marked on the proxy card or VIF.

In connection with the proposal to amend NYSE Rule 452, we received several comment letters that discussed advance voting instructions as an alternative to the NYSE Rule 452 amendment or advocated that such voting instructions should be considered in conjunction with the NYSE Rule 452 amendment. In the order approving the NYSE Rule 452 amendment, we noted that advance voting instructions raise a variety of questions and concerns, such as requiring investors to make a voting decision in advance of receiving a proxy statement containing the disclosures mandated under the federal securities laws and possibly without consideration of the specific issues to be voted upon. The Proxy Working Group also expressed concern that advance voting instructions could act as a disincentive for retail investors to vote after reviewing proxy materials if they had already given such instructions. On the other hand, supporters of advance voting instructions stated that the implementation of voting based on such instructions could help issuers solve quorum problems, encourage greater retail shareholder participation in the voting process by making it easier for investors to vote, better permit shareholders to exercise their franchise, and result in more discussion and involvement between investors and their brokers on proxy issues.

While we will continue to consider the advisability of allowing third parties, such as broker-dealers, to solicit instructions regarding the voting of shares by retail investors without the benefit of information that is contained in disclosures that our rules require in connection with shareholder votes, we recognize that facilitating the use of advance voting instructions can be viewed as providing retail investors with a component of the services now made available to institutional investors by proxy advisory firms. However, retail investors are not necessarily in the same position as institutional investors. Some institutional investors rely upon pre-developed voting policies and procedures to ensure consistency across portfolios, to aid in post-vote monitoring and reporting, and otherwise to comply with applicable fiduciary duties. Some retail shareholders may not be as likely to monitor, or hire others to monitor, the application of their advance voting instructions.

There is currently no applicable exemption for securities intermediaries to solicit advance voting instructions from their customers. Exchange Act Rule 14a-2(a)(1) provides an exemption from the proxy solicitation rules to securities intermediaries when they forward proxy materials on behalf of issuers and request voting instructions. This exemption, however, requires securities intermediaries to "promptly furnish" proxy materials to the person solicited. By definition, brokers seeking to obtain advance voting instructions from customers would not be able to satisfy this requirement. In the absence of an applicable exemption for the solicitation of advance voting instructions, Rule 14a-4(d) states that no proxy shall confer authority to vote at any annual meeting other than the next annual meeting after the date on which the form of proxy is first sent. In addition, that rule prohibits a proxy from granting authority to vote with respect to more than one meeting.

To pursue this alternative further, there are a number of issues that would need to be considered. Advance voting instructions could be solicited to varying levels of detail. For instance, such an instruction could be very broad, such as "vote consistent with management's recommendations" or "vote consistent with the recommendations of XYZ Environmental Group." The grant of such broad authority could raise concerns about the extent to which the investor's vote is an informed one. Greater specificity in a request for instructions, however, could provide an investor with greater certainty regarding what his or her instruction relates to. For example, an instruction to "vote consistent with [management's or other party's] recommendations regarding corporate governance issues" would provide more certainty.

In addition, if we were to permit advance voting instructions, we would need to address other issues including whether such instructions should be re-affirmed on a periodic basis; whether they should apply to the voting of shares of issuers that the investor did not own when the original instructions were submitted; whether they should be re-affirmed each time an investor purchases additional shares of an issuer's stock for which that investor has already submitted voting instructions; and whether brokers can seek from investors advance voting instructions that vary by company.

We are interested in receiving views on whether permitting advance voting instructions would increase retail investor participation in the voting process, and on whether such instructions would be appropriate as a general matter. If such instructions would increase retail investor participation and would be appropriate, we are interested in receiving views on any conditions or requirements that we should consider applying to the solicitation of such instructions.

...

3. Request for Comment

...

With respect to advance voting instructions, we ask the following questions:

- Should we consider allowing securities intermediaries to solicit voting instructions in advance of distribution of proxy materials pursuant to an exemption from the proxy solicitation rules? Should there be any conditions on any such exemption, and if so, what should they be?
- To what extent would voting instructions made without the benefit of proxy materials result in less informed voting decisions? Are there countervailing benefits to permitting the solicitation of such instructions? To what extent does the revocability of advance voting instructions mitigate concerns over less informed voting decisions?
- With regard to the use of advance voting instructions, are retail investors at a disadvantage as compared to institutional investors that use the services of a proxy advisory firm? If so, how? Are there aspects of the services and relationship between proxy advisory firms and their clients that would not exist between securities intermediaries soliciting advance voting instructions and their customers? If so, how should these differences be addressed, if at all?
- If such solicitation of advance voting instructions were permitted, what level of specificity should the solicitation of advanced voting instructions be required (or permitted) to have? Is it appropriate to permit the solicitation of a broad scope of voting authority?
- Should we allow the solicitation by securities intermediaries of advance voting instructions for all types of proxy proposals, or should it be limited to certain types of proposals? For example, should we permit solicitation of advance voting instructions with respect to shareholder proposals, proxy contests, or proposals subject to "vote no" campaigns?
- If solicitation of advance voting instructions were permitted, should the investor be permitted to instruct the securities intermediary to vote in accordance with the recommendations of management, a proxy advisory firm, or other specified persons? How neutral or balanced should the solicitation of advance voting instructions be?
- If we were to allow the solicitation of advance voting instructions, should we require an investor to reaffirm its voting instructions periodically? If so, how often? Should we require an investor to reaffirm its voting instructions every time it purchases additional shares of a stock for which that investor has already submitted a voting instruction, or when it purchases shares of a new issuer?
- If we were to allow advance voting instructions, what would be an appropriate range of options available to an investor? Should advance voting instructions only be permitted when the investor has meaningful options from which to choose?

- How difficult would it be to obtain advance voting instructions from existing brokerage customers? What would be the costs of obtaining advance voting instructions for existing accounts? Who should bear the costs of soliciting such instructions?
- If we were to allow the solicitation of advance voting instructions, would it undermine or promote the purpose of the recent amendment to NYSE Rule 452 to prohibit brokers from voting uninstructed shares in uncontested elections of directors?

Summary of Broadridge Preliminary CDV Model

The Broadridge preliminary work on a CDV model has been driven largely by principles similar to those developed by SCSGP, notably the following:

- RBOs should receive no less disclosure in a CDV model than they do today;
- CDV should be easy to use, easy to access and provide access to a broad array of voting views;
- RBOs should retain ultimate control of their votes up to the voting deadline;
- RBOs should be able to view and modify their preferences at any time;
- RBOs should be able to terminate participation at any time; and
- RBOs should have to take affirmative action to participate in the CDV service.

When an RBO first logs into the CDV service, expected to be available via the RBO's Web-based account at his or her broker or bank, the RBO would be asked to set account preferences, including advance voting instructions. By contrast to Broadridge's ProxyEdge product for institutional investors, in which an investor typically sets advance instructions for hundreds of proposal categories, RBOs would set advance instructions for a limited subset of proposals, comprising the most common and easily defined proposals (e.g., staggered boards or cumulative voting). When setting advance instructions, a RBO could access "external views," consisting of a limited number of "advocates" from which to choose. Advocates could be individual institutions or represent an investment style and would be included only upon the initiative of the particular advocate. Inclusion of particular advocates would be subject to any minimum standards or conditions that the SEC might eventually impose. Advocates would be classified by type (e.g., "socially-responsible investors"), with advocates being identified to the classifications of their choice. An RBO seeking external views would select a classification to view a list of relevant advocates and could view any of the advocate's voting guidelines as provided to Broadridge. The RBO would set an expiration date for his or her advance instructions at which time the RBO would be called upon to renew the instructions. Pending the expiration date, the RBO's user profile would remain accessible and subject to change by the RBO at all times.

From the main screen, the RBO also would have access to a list of upcoming shareowner meetings in which he or she would be eligible to vote, and could click directly into the VIF for a meeting for which the voting deadline had not yet occurred. By viewing the VIF for a particular meeting, the RBO would see all the proposals subject to a vote at that meeting and how his or her advance instructions would be applied to each proposal. To the extent an advocate volunteered its actual voting intention (or vote) in advance of the voting deadline, the RBO could view that information. The RBO could also compare available voting recommendations or actions of various advocates side-by-side, among other analytical tools that would help the RBO to compare the views of relevant advocates.

The RBO could manually override a standing instruction and recast his or her vote at any time before the ordinary-course voting deadline. Absent an override, the RBO's shares would be voted automatically in accordance with his or her advance instructions. In the VIF, the RBO could also vote on proposals not subject to his or her advance instructions.

The CDV service would provide various confirmation and reporting services to RBOs. For example, the RBO could elect to receive a confirmation as to whether Broadridge has received and processed its VIF. Reports, including a summary of how the voting outcomes of shareowner meetings in which the RBO participated compared with the RBO's own votes, could be created. The RBO would also have access to other features, including shareowner announcements, a list of open votes for upcoming shareowner meetings for completion by the RBO, investor education tools and various shareowner forums.

SCSGP Principles Relating to CDV

Principles for Implementation of Client Directed Voting By Brokers and Bank Custodians

Members of the Society of Corporate Secretaries and Governance Professionals have spent nearly two years developing an approach to “client directed voting,” or CDV, that is workable and balanced. CDV is tool designed to make it easier for retail shareholders to vote their proxies at annual or special shareholder meetings. It is our view that CDV will help to rectify an imbalance in the proxy voting system by increasing the number of retail shareholders who vote their proxies. Retail voting levels have hovered in the 20 percent range, and an even lower 5 percent range under Notice and Access (where shareholders are notified of the electronic availability of proxy materials).

In developing this approach, we have consulted with other interested parties. Under our proposed approach, the SEC would provide general guidance under the federal proxy rules, and any group would then be free to offer CDV in a manner consistent with that guidance.

Below is a summary of the principles that we believe should guide a CDV platform implemented by brokers and bank custodians.

Participation with CDV would be entirely optional. Under CDV, a shareholder would be invited to provide his or her broker or bank custodian with advance instructions for the voting of certain types of proposals put forward by the company or by another shareholder. A shareholder, for instance, could instruct his or her broker or bank to always vote in favor of shareholder proposals to split the roles of CEO and Chairman. That shareholder would then have the option of over-riding his or her own advance instructions at any time prior to the normal deadline for providing voting instructions.

A shareholder who has elected to participate with CDV would continue to receive proxy materials in the same time frames as in the past. However, the shareholder’s voter instruction form, or VIF, would indicate which proposals are the subject of advance instructions, and provide a means to over-ride such instructions. In addition to providing proposal-specific advance instructions, shareholders would be permitted to provide default instructions, such as to register votes in proportion to other retail shareholders, explained in more detail below.

General Principles

- Investors participating in CDV should receive no less disclosure and other information than they do today, and should receive the same proxy materials in the same time frame that they do today.
- Investors should retain ultimate control over their votes up until the ordinary course deadline for voting.
- Investors should be able — at any time — to view their CDV preferences, modify their preferences, and terminate their participation in the program.
- CDV should require affirmative action by an investor in order to elect to participate in CDV — including the need to choose a set of voting preferences — so that there may be no presumed or automatic enrollment.

- CDV should be simple and straightforward to use, so that investors actually use the system and clearly understand how their votes will be registered. A system that, initially, is weighed down with complicated features or imposes excessive burdens on those who implement it in terms of operating the system or maintaining a customer base may not work as a practical matter.
- It is our expectation that CDV will improve over time in overall usability and functionality by investors, just as Microsoft evolved DOS into Windows 7 over time.

Intermediaries Offering CDV

- Participation by brokers, bank custodians, and other intermediaries should be voluntary, and each intermediary should have flexibility to make CDV available to all of its clients, or only to a segment of its clients. We expect that some intermediaries may wish to roll out CDV gradually, initially offering it at first only to one segment of its clients, but then later offering it to others.
- CDV should be “open-architecture” in the sense that it can operate as a feature of any underlying “proxy plumbing” system, and regulatory guidance should not limit or restrict by its terms who implements CDV, so long as those implementing the program comply with applicable standards and conditions. By the same token, conditions and prerequisites for CDV imposed by regulators on brokers/banks should apply equally to all providers of CDV, whether they are brokers/banks or other intermediaries. We anticipate that other groups, including investor-sponsored web sites, will offer alternative CDV mechanisms consistent with regulatory guidance.
- CDV may be offered to all shareholders regardless of their form of ownership, including “street name” holders, registered holders, and even holders through nominee accounts.
- Intermediaries who implement CDV should play an administrative role, meaning that they may not influence the CDV preferences selected by participating clients, or otherwise influence client voting decisions. Brokers however may continue to respond to unsolicited client inquiries consistent with current proxy rule exemptions, including by responding to requests for advice on whether and how to participate with CDV.

CDV Mechanics

- Initially, brokers and bank custodians will likely offer CDV to their clients who access and vote their ballots electronically (such clients may request paper copies of the disclosure for their review). Offering CDV to paper-based customers will be reviewed as a second-step.
- CDV will operate in a manner that permits an investor to provide advance instructions applicable to all companies in his or her portfolio, coupled with an opportunity to override those instructions at any time by casting a manual vote. (A vote manually entered by a shareholder will always trump a standing instruction.)
- CDV will include a list of relatively clear-cut company and shareholder proposals or proposal types that may be the subject of proposal-specific advance instructions (e.g., shareholder proposals to split chairman/CEO positions) to vote for, against, or abstain. A shareholder who wishes to enter advance instructions, but then review his or her vote on a particular type of proposal on a company by company basis (after receiving the proxy materials) may choose to “abstain” by default on that proposal type. (As is always the case, if the investor elects not to enter any advance instructions, then no vote will be registered unless/until the investor enters manual votes on a company-by-company basis, as is the case today without CDV).

- CDV participants will be permitted to customize advance instructions that would apply to all proposals, except for Excluded Topics, as noted below, with reference to specific voting policies reflecting a broad spectrum of investor viewpoints, and which are publicly available or otherwise placed on the platform on acceptable terms. In effect, investors would be permitted to design their own advance instructions upon review of these publicly available voting guidelines. In addition to the option of customizing their advance instructions, investors will be permitted to choose from other voting approaches, similar to the selections offered by proxy advisors to their institutional investor clients. These may include advance instructions that reflect strong support for management, weak or neutral support for management, and voting in proportion to other retail shareholders (for clients of participating brokers and banks). Depending on cost and logistical issues, the first two default selections noted above may at least initially be “always in favor” or “always against” the board’s recommendations, but we would endeavor to replace those selections eventually with forms of proxy advice. There may be additional sets of advance instructions offered. Advance instructions can always be over-ridden by a vote that an investor has manually entered. Any proposal-specific standing instruction (as described in the above bullet) will similarly take precedence of any general standing instruction.
- Each of the proxy card/VIF (and the Notice card at such time that paper clients are permitted to participate) will prominently reflect the investor’s pre-existing advance instructions, reflecting how a given proposal will be voted absent further action by the investor. The proxy card/VIF will provide easy means for the investor to override advance instructions on a given proposal. *Note: Some publicly available voting guidelines or recommendations noted in the above bullet may be unavailable for a particular company until after that company’s definitive proxy materials are filed and mailed insofar as the investor may choose to follow the voting patterns of another investor, or rely on updated voting recommendations. This means that an individual retail investor’s corresponding advance instructions could not be reflected on the VIF possibly until a short time before the shareholders meeting.*
- The CDV mechanism would not apply to proposals to approve or disapprove a significant corporate transaction, nor would it include proposals that are the subject of a proxy contest in which shareholders solicit support for one or more proposals on a separate proxy card from the company’s proxy card (collectively, “Excluded Topics”).
- An investor will be reminded of his or her participation in CDV each time he or she accesses or receives a VIF (and Notice for paper clients once paper clients are able to participate in CDV) reflecting his or her advance instructions. The website where clients access their brokerage accounts could also include a reminder that the investor has active advance instructions in place — prominently displayed on the page where equity positions are listed — and the investor could click through to view (and change) his or her advance instructions at any time. The page with CDV advance instructions could also include a prominent “unsubscribe” button, making it easy for an investor to terminate participation in CDV.

Selected Resources

As part of our review of CDV, we interviewed several individuals representing a range of perspectives and experience with the current proxy voting framework, including representatives of institutional investors, members of the business community, representatives drawn from the RBO community, lawyers active in governance matters and representatives of broker-dealers and other intermediaries. With the permission of the Council of Institutional Investors, we conducted these interviews on a confidential basis. In all cases, the views expressed were those of the individual and not necessarily representative of any particular constituency. Unattributed commentary in this paper derives from these interviews. We wish to thank these participants, whose contribution to framing the issues associated with CDV was invaluable.

Other Key Resources:

1. ADDENDUM TO THE REPORT AND RECOMMENDATIONS OF THE PROXY WORKING GROUP TO THE NEW YORK STOCK EXCHANGE (2007)
2. Frank G. Zarb, Jr. & John Endean, *Restoring Balance in Proxy Voting: The Case for "Client Directed Voting,"* Harvard Law School Forum on Corporate Governance and Financial Regulation (Feb. 14, 2010), available at <http://blogs.law.harvard.edu/corpgov/2010/02/14/>
3. Frank G. Zarb, Jr. & John Endean, *The Case For 'Client-Directed Voting,'* Law360 (Jan. 4, 2010), available at <http://www.law360.com/articles/140395>
4. John Wilcox, *Fixing the Problems with Client Directed Voting,* Harvard Law School Forum on Corporate Governance and Financial Regulation (March 5, 2010), available at <http://blogs.law.harvard.edu/corpgov/2010/03/05/>
5. Mark Latham, *Proxy Voting Brand Competition,* 5 J. of Investment Mgmt. 79 (2007)
6. James McRitchie, *An Open Proposal for Client Directed Voting,* Harvard Law School Forum on Corporate Governance and Financial Regulation (July 14, 2010), available at <http://blogs.law.harvard.edu/corpgov/2010/07/14/an-open-proposal-for-client-directed-voting/>
7. Letter from Robert Schifellite, Broadridge, to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n (Nov. 23, 2009)
8. Letter from David W. Smith, Pres., Soc'y of Corp. Secretaries & Governance Professionals, to Thomas Kim, Chief Couns., Div. of Corp. Fin., Sec. & Exch. Comm'n (Aug. 7, 2009)
9. Rules under the Securities Exchange Act of 1934
 - a. 17 C.F.R. § 240.14a-1 (2009)
 - b. 17 C.F.R. § 240.14a-2
10. SEC, Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010), available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.



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