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NYSE Proposes to Update Proxy Distribution Fees

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At the end of August, the New York Stock Exchange submitted rule proposals to the Securities and Exchange Commission to update the way brokers are reimbursed by issuers when they distribute proxy materials. The new proposals would adjust reimbursement rates, and also fundamentally change the manner in which some rates are applied. While the exchange has temporarily withdrawn the proposals, it is expected to re-submit them in the near future, possibly with some adjustments, but largely in the same format.

Under SEC rules, brokers are required to forward proxy materials to an issuer's shareholders, but are entitled to be reimbursed for the related costs. The SEC defers to the NYSE in setting applicable reimbursement rates. The current rule proposals focus on those reimbursement rates.

The Proposals

The SEC is likely reviewing the NYSE's original proposals, despite their later withdrawal by the NYSE, which could result in further changes. Once resubmitted by the NSYE, the SEC is required to publish the proposals for public comment before adopting final rules. New rules or proxy reimbursements could become effective in 2013, although that date could be delayed in the event of extended internal deliberations at the SEC.

The new fees would among other things:

- Adjust the "nominee fee", "processing unit fee" and "intermediary unit fee" upward for inflation, but tier each fee at five levels to reflect incremental economies of scale.
- Eliminate reimbursements for certain categories of transactions, e.g., managed accounts with five or fewer shares.
- Rename incentive fees as "preference management fees" to reflect ongoing broker costs, and set such fees at a fixed 32 cents (compared to the current rates of 25 cents or 50 cents, depending on the size of the distribution). Incentive fees apply

when an investor consents to electronic delivery of proxy materials, which is less costly, and in other analogous circumstances.

- Eliminate reimbursements for managed accounts with five or fewer shares, and reduce the "preference management fee" to 16 cents to reflect shared benefits between issuers and brokers from maintaining managed accounts.
- Regulate fees charged issuers for administering the "notice and access" form of delivery for proxy materials, which is currently unregulated by the NYSE. The applicable fees would remain the same as in the past, however.
- Cut in half fees for follow-up mailings that remind investors to return proxy votes, citing a policy to encourage retail voting.

The NYSE states that the new fee structure is expected on balance to result in a modest decline of about 4% in overall proxy distribution fees paid by issuers.

The proposals follow years of criticism of the current fee structure from some issuers and transfer agents. In 2010, the SEC addressed this criticism, among a wide spectrum of other matters, in a concept release widely referred to as the "Proxy Plumbing Release," available at http://www.sec.gov/rules/concept/2010/34-62495.pdf. Distracted by the obligation to draft new rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and more recently under the JOBS Act, the SEC has not to date issued any rule proposals to address issues identified in its Proxy Plumbing Release. However, at the SEC's urging, the NYSE in 2010 formed the Proxy Fee Advisory Committee (PFAC), composed of representatives of issuers, brokers, and regulators, with a mission to update proxy reimbursement rates. The PFAC issued a report in May 2012. The NYSE rule proposals largely reflect the PFAC's recommendations.

The NYSE proposals do not address several issues that some expected the exchange might address. These include proxy reimbursement rates for mutual funds, broker incentives to implement internet platforms to facilitate proxy voting by retail clients, and the fees charged issuers that wish to obtain a list of their "non-objecting beneficial owners," or NOBOs. NOBOs are brokerage clients who do not object to disclosure of their names and share positions to issuers. Brokers are required to withhold such information about their clients other than those that are NOBOs.

Finally, the proposals do not address "client directed voting," a reform supported by many issuers and market intermediaries, which is designed to encourage retail shareholders to vote their proxies. Under this system, retail shareholders would be allowed to provide their brokers with standard voting instructions in advance of the proxy season, similarly to the manner in which institutional investors provide proxy advisors with standard voting instructions. Client directed voting would likely operate in tandem with internet voting platforms maintained by brokers.

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