WEBINAR

Proxy Voting 101

Everything You Wanted to Know About the Proxy but Were Afraid to Ask

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Speakers

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US Proxy Processing

US Proxy Process Overview

- A majority of public companies' shares (70-80%) are held in "**street name**"
  - Shares held in "**street name**" are held of record through **The Depository Trust and Clearing Corporation** (**DTCC**) by participant broker-dealer and banks who, in turn, hold shares on behalf of their clients, the individual beneficial owners
  - The "**street name**" system was developed in stages over the last 40 years to replace physical exchange of certificates and checks, and underlies the US market's ability to handle tremendous trading volumes, encourage greatly increased participation in the capital markets and support significant innovation in financial products
- As the "legal" owner of shares, only the shareholder of record has voting rights
  - Upon the record date established for a company's annual meeting (identifying those holders eligible to vote), DTCC provides a list of broker-dealers, banks and other institutions that hold the company's shares in street name <u>and</u> issues an "**omnibus proxy**" to transfer the voting rights to these participants
  - Street name or beneficial shareholders do not have direct voting rights
  - Beneficial shareholders, generally by contract with their bank or broker, have the right to provide 'voting instructions' to their bank or broker, who, in turn, has the legal right to actually vote those shares

Voting Entitlement

Issuing Corporation

1,000,000 outstanding shares

Transfer Agent

Registered Shareholders are known to the Transfer Agent, who acts as the record keeper.

Registered Shareholders

John Q.	3,000 shares
Jane P.	7,000 shares
Jim O.	44,000 shares
CEDE & Co. [DTCC]	946,000 shares
	1,000,000 shares

Chain of Entitlement

DTCC provides an Omnibus Proxy to their Participants (banks and brokers), which conveys voting entitlement for the shares held as of the record date.

DTCC

The Depository Trust & Clearing Corporation

946,000 custodied shares

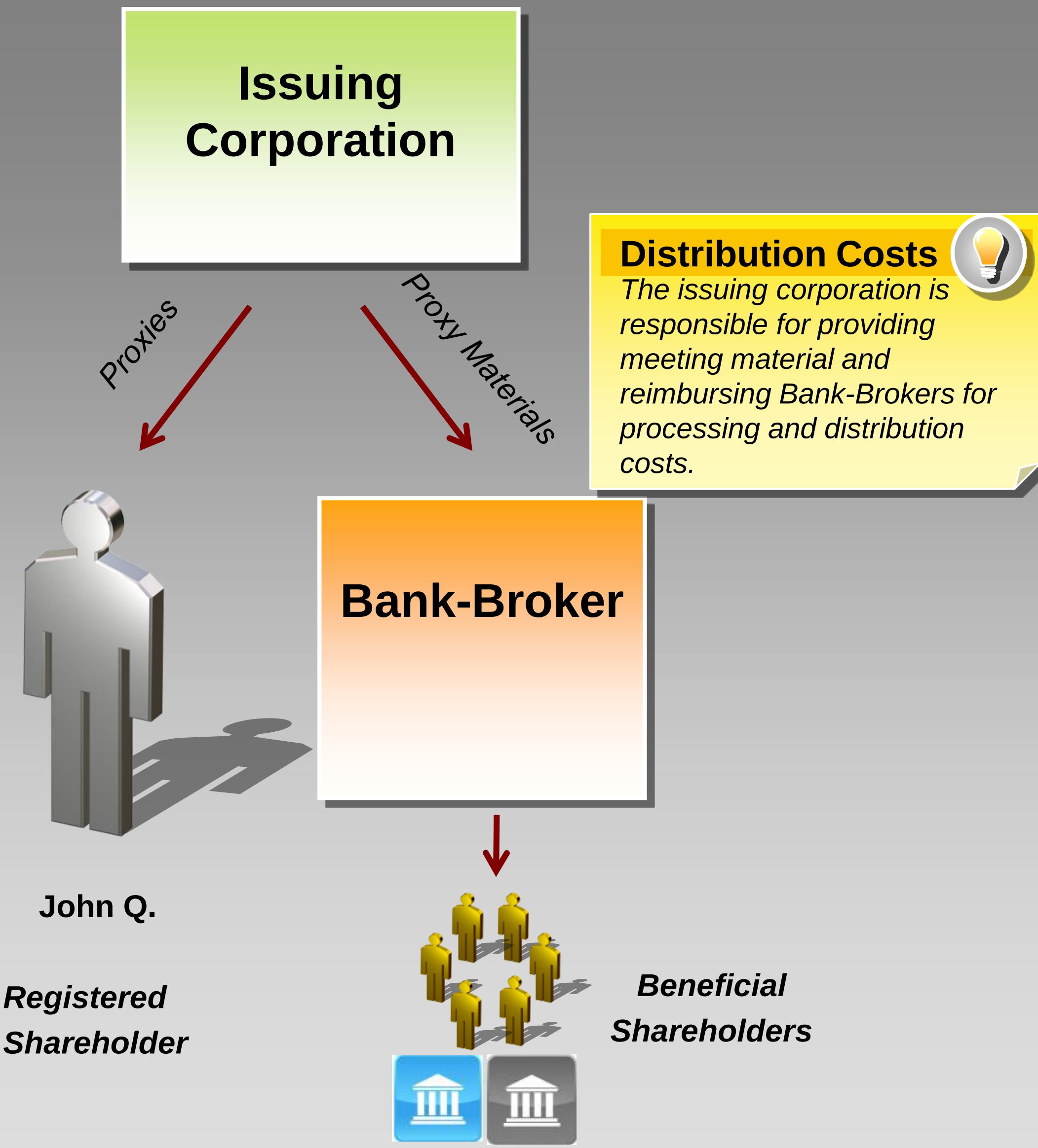
Bank-Broker A	***Bank-Broker B***	***Bank-Broker C***	***Bank-Broker D***	***Bank-Broker E***
146,000 shs	200,000 shs	100,000 shs	200,000 shs	300,000 shs

Beneficial Shareholders

Entitlement Overview

Beneficial shareholders are known to their Bank-Broker, who acts as the record keeper. The account positions as of the record date are entitled to vote and receive proxy solicitation materials electronically or via paper.

Material Distribution



Issuing Corporation

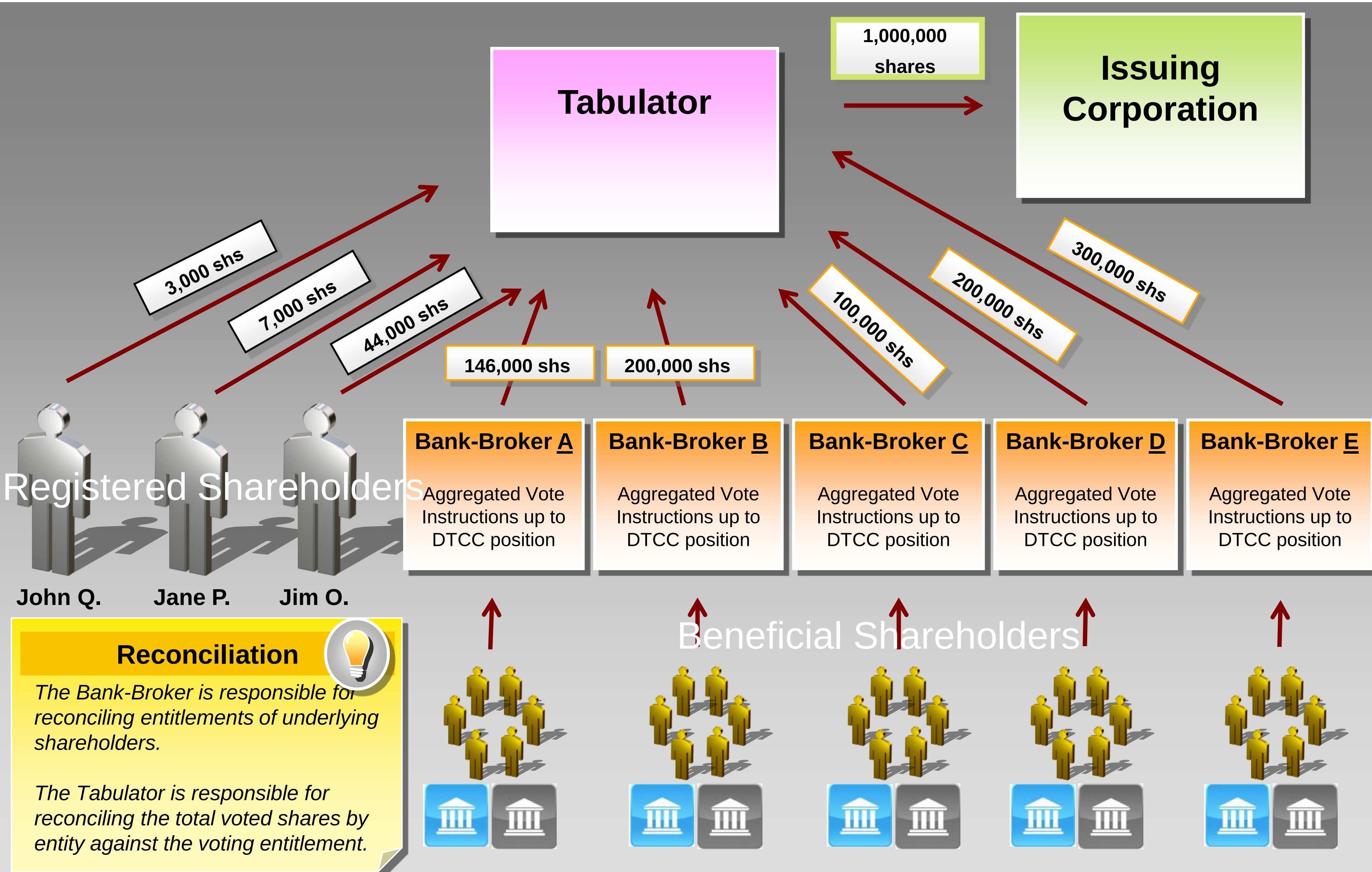
- Issuing corporation or its agent distributes proxies to the registered shareholders
- Registered shareholder is able to vote by proxy or at the meeting

- Issuing corporation distributes proxy solicitation materials to Bank -Brokers identified on the Omnibus Proxy

Bank-Broker

- Bank-Broker or their agent distributes materials and Vote Instruction Forms to individual beneficial shareholders
- Beneficial shareholder provides instructions to their Bank-Broker, who actually votes the shares. Beneficial shareholder can vote in person by requesting a Legal Proxy in advance.

Share Voting



Voting Entitlement

Voting Entitlement

- Voting Entitlement is based on the stock record
  - Stock record of beneficial ownership is the <u>sole</u> determining source of which accounts can be allocated voting rights
    - Only long holders of record are eligible to be allocated voting rights
    - Short sellers, which require borrowed securities to effect delivery of their sale, are never allocated voting rights
      - Short sellers obtain a “locate” from their broker
      - Short sale is executed
      - Broker borrows the shares and delivers them to the buyer on settlement date
      - The buyer obtains the voting rights with the shares
      - The lender gives up their voting rights
      - The short seller <u>never</u> had any voting rights as they never obtain possession
    - Share borrowing never establishes long beneficial ownership in a broker’s stock record

Voting Entitlement

- Differences between pre-reconciliation vs. post-reconciliation
  - **Pre-Reconciliation:** reconciling account holders’ positions prior to distribution of vote instruction forms
    - The broker-dealer accounts for shares on loan, market fails and similar adjustments prior to sending out the voting instruction forms to clients
    - Clients' votable shares are reduced to match the inventory of shares held by the broker-dealer on record date prior to mailing of materials
  - **Post-Reconciliation:** reconciling account holders’ positions after distribution of vote instruction forms and only when total shares instructed exceeds the client voting position (generally results in more shares voted)
    - The broker-dealer sends out voting instruction forms to clients in accordance with the long positions of their clients' accounts irrespective of the inventory of shares held by the broker-dealer on record date
    - Should returned votes exceed the broker-dealer's inventory, the broker-dealer reduces client vote totals to a level in line with their inventory of shares held on record date

Empty Voting

- **“Empty voting”** is generally defined as having voting rights without having an economic interest (i.e., borrowing company stock to manipulate the outcome of company vote)
  - Only beneficial owners of the security are allocated voting rights
  - Short sellers create the demand for borrowing but are <u>never</u> allocated voting rights
  - Shareholders can effectively hedge or eliminate their economic exposure to a company while maintaining voting rights, so long as they maintain a long beneficial ownership position in the stock undergoing the proxy and maintain possession of those shares over record date:
    - Selling their holdings between the record date and meeting date avoiding economic exposure by meeting date
    - Entering into separate short sale transaction (prior to record date) by borrowing the stock while maintaining their fully-paid for long position (short against the box)
    - Entering into derivatives transactions (options or swaps) which hedge their economic exposure to a security while maintaining voting rights with respect to their beneficial ownership in the underlying stock

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Securities Lending

Securities Lending Example

- Securities lending serves many important roles in capital markets including:
  - Providing liquidity
  - Facilitating settlement
  - Allowing short sales
- Investor A has 100 shares of Issuer X in her account
- Investor S doesn’t own shares of Issuer X but believes the price of its stock will fall, so S decides to sell short 100 shares of X
- S’s broker must locate 100 shares of X and Investor A agrees to lend her shares for a fee
- Investor B wants to buy 100 shares of X and happens to buy the shares lent by A and sold short by S, but B doesn’t have any knowledge of this and it’s not important.
- S never has possession of the 100 shares and never has voting rights
- A had voting rights but once the shares were lent, she lost them
- B now has the voting rights
- There are some nuances between institutional lending through custodians and broker lending from margin accounts through rehypothecation.

Important Takeaways

Important Takeaways – Proxy Processing

- Registered ownership voting rights are generally conferred by state law
- Beneficial ownership voting rights are generally conferred by contract between the bank or broker and its client
- Shares held through banks are held in segregated accounts
- Shares held through brokers are treated as a ‘fungible mass’ but all shares can be reconciled to an individual account when necessary
- Institutions generally have specific share lending agreements that include the ability to see shares on loan real-time, recall shares, and that provide for voting rights going with the shares on loan
- Margin accounts through brokers allow the account holder to borrow against their account (i.e., borrow the broker’s money) to purchase securities, but in turn the broker has the right to lend collateral shares from that account without previous or specific authorization from the account holder
- In a short sale, shares are borrowed for the specific purpose of delivering shares to the buyer of the short sale. The buyer of those shares on the other side of a short sale has voting rights. The borrower of the shares does not have voting rights over those shares at any time.
- Federal Reserve Board Regulation T specifically prohibits the borrowing of shares to obtain voting rights; it is enforced by FINRA

Important Takeaways – Proxy Processing

- Tabulator responsibilities include preventing over voting by requiring nominees to reconcile over reported positions to the true votable position – usually the DTCC position
- Broker pre-reconciliation is the practice of reconciling account holders' positions prior to distribution of vote instruction forms
- Broker post-reconciliation is the practice of reconciling account holders' positions after distribution of VIFs and only when total shares instructed exceeds the nominee voting position, which is a rare occurrence; post-reconciliation generally results in more shares voted
- True end-to-end confirmation takes place today and the practice, supported by issuers and institutions, can and should be rapidly expanded by formalizing existing information exchange between tabulators and nominees or their agents
- Empty voting is generally defined as having voting rights without having an economic interest; there isn't a requirement today to have an economic interest on meeting date in the US; general practice is to enfranchise beneficial owners with a 'long' position on record date

Important Takeaways – Securities Lending

- The vote moves with the loaned share
- The borrower does not vote the share
- The dividend is paid to the new buyer
- An “in lieu of” dividend is paid to the lender
- The short seller pays the dividend to the lender
- There is no “in lieu of” vote
- Long positions may exceed shares outstanding
- Short interest may exceed shares outstanding

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Thursday, February 15, 2018
2:00 - 3:00 pm ET

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Questions

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