

Broker-Dealer Functions Supporting Proxy Distributions

While third party vendors, such as Broadridge, provide distribution services for many broker-dealers, broker-dealers still have regulatory responsibility and oversight, and engage in a broad range of proxy processing activities internally. These activities include broker-dealer functions necessary to support services provided by third party vendors, functions carried out exclusively by broker-dealers, and maintenance of infrastructure needed to support their proxy responsibilities¹.

The activities of broker-dealers to support proxy services can be broadly classified into 5 main categories:

- 1. Preference management**
- 2. Infrastructure / Vendor Data Exchange**
- 3. Oversight / Supervision**
- 4. Client Service**
- 5. Record Retention**

While these are the core categories of functions, broker-dealers deliver varying levels of service to their clients, based on their size and operating model, to name two of many variables. Below is an illustrative view of firm activities around proxy processing, which attempts to summarize general practices grouped according to the above functions. When reviewing the proxy processing activities performed by the broker-dealer community, it should be recognized that there is not a 'one size fits all' approach that is taken. Rather, each broker-dealer utilizes their own set of processes to fulfill their obligations relative to proxy distribution.

1. Preference Management

Various regulations govern customer instructions and require the storage of original communications with clients as well as copies of all actions taken on behalf of a customer. Activities include notification of opportunities and various disclosures, receiving customer preferences, and properly storing preferences for use within the proxy process. Proper supervision and recondition of all customer preferences ensures accurate usage.

- Customer Preferences

- **Notice + Access:** The Notice and Access (N&A) regulations provide for customer access to full sets of material upon request if an issuer elects to utilize the N&A provisions in a solicitation campaign. Customers can request material for a specific event or elect to always receive full sets of material by contacting their broker-dealer or agent. Broker-dealers need to obtain material, either through a vendor, agent or possibly directly with the issuer, and maintain the elections for use in future campaigns.

¹ It is also note worthy that not all issuers utilize vendors such as Broadridge, and each year Broker Dealers work with many issuers on direct proxy distribution to shareholders.

- **NOBO OBO:** Rules require that broker-dealers default customers to a Non-Objecting Beneficial Owner (NOBO), which allows for the disclosure of the client's name to an issuer if asked. Broker-dealers must disclose the rule and provide provisions that allow a customer to elect to become an Objecting Beneficial Owner (OBO), which prevents the release of the customer name. Client elections are maintained and stored usually internal to a broker-dealers infrastructure and need to be accessed for the generation of NOBO reports.
- **House Holding:** Regulations allow for the consolidation of material for individuals that reside within the same household. This practice reduces packaging and postage for issuers. While infrastructure typically utilizes logic to identify last names of customers and consistent addresses for consolidation, customers may choose to opt out of house holding, or have situations that fall outside of conventional criteria. Instruction management internally and with vendors includes the completion and submission of forms to accommodate clients' requests.
- **E –Delivery:** Customers must provide positive consent to have material distributed electronically to an email address. Broker-dealers manage the process of recording preferences and valid email address for various types of documents. This includes the confirmation of valid domain names, accommodations for changes to email addresses and preferences, and communication for email failures, which can be both a hard failure (email address is no longer valid), or a soft failure (can include situations where the mail-box is full, or domain issues). These steps help ensure that the most up to date preference is utilized and that the customer receives material for a campaign.
- **Special Handling / Exception Processing:** Special handling has many formats, and is usually a specific request that falls outside of the basic infrastructure. This can include special re-direction requests as well as account bundling that reduces sets of material. Broker-dealers may need to change settings on their own system or possibly complete and submit forms to vendors for these situations. An example of such would be an outside manager who wishes to have their accounts bundled and sent to one addressee.

- **Investor Advisor Relationships**

- **Maintenance of customer/advisor preference for re-direction and aggregation:** Customers may choose to have an advisor manage their proxy distribution and voting. Broker-dealers need to review and retain customer relationships and authorization, which can vary based upon the type of material that may be distributed with various aggregation requests. In addition, an advisor may outsource their voting, requiring another level of relationships for re-direction and aggregation. As customers change their preferences, or advisors acquire new accounts or lose account relationships, preference instructions are constantly updated on both the internal and external vendor applications for use in the proxy process.
- **ERISA / 1940 Act:** Certain advisors may be subject to enhanced fiduciary rules that require greater oversight of preference and voting practices. Certain advisors utilize internal or third-party software to assist with the management of these accounts. Broker-dealers provide support for re-direction and enhanced client services to ensure regulations are met.

2. Infrastructure - Vendor Data Exchange

Broker-dealers need to have and maintain the appropriate infrastructure to support both their own internal proxy processing activities, which include preference management, and the services contracted with a third party vendor where applicable. These may include:

- Secure transmission lines to move files between vendors and broker-dealers (due to the size of data requests, most broker-dealers have a T-1 line dedicated to transmitting proxy files);
- Mainframe programs dedicated to accepting and producing broker-dealers' nightly files for the vendor, and IT support to monitor the successful nightly transmission of the file.
 - o Software applications to identify customer-voting entitlement positions and reconciliation to voting positions.
 - o Technology to store customer delivery preferences and to apply preferences to the customer mailing file. There is a split between broker-dealers who outsource this to third party vendors, and those who provide a file of preferences to third party vendors.
- Electronic Brokerage Internet Platforms (EBIP), such as Investor Mailbox, involves the creation of a page on the broker-dealer online platform that houses proxy information, so that clients can review proxies in one location, and act on them. Clients have access to this platform regardless of whether the materials were delivered in hardcopy or electronic format. Third party vendors provide a nightly file of proxy activity to populate this page, and real-time access for voting, which results in a fee-liable service for the broker-dealers (that provide it). A number of broker-dealers offer the EBIP solution to provide clients with a single point of entry for seamless voting on all distributions sent by vendors.
- **Daily Request File and Transmitting Data:** Broker-dealers are responsible for a range of daily data exchange processes to support their contracts with third-party vendors or internal mailing facilities. These processes include:
 - o Broker-Dealers receive a daily file from third party vendors which contain a list of CUSIPs that are impacted by proxy, interim reports and reorganization mailings. On the file there is an identifier for each type of mailing.
 - o Broker-dealers send back entitled accounts, including the account number, account address (electronic or manual), and the number of shares each account owns.
 - o Broker-dealers and vendors exchange supporting database values which contain a variety of information used within the process, including parts for aggregation and customer preferences, etc.

- Technology also links with various services, such as the Move Update database from the United States Postal Service (USPS), to ensure that the most current address for a customer is used, also allowing the issuer to receive the best postal discounts.
 - Vendors will generate files and reports that list the Security Name and CUSIP, the record date of the meeting, the total number shares the broker-dealer transmitted to the vendor for that particular CUSIP, and the total number of shares DTCC shows that the broker-dealer owned on the record date.
 - Broker-dealers build reconciliation files and reports for validation, which are downloaded on a daily basis, to research position balances and exceptions.
 - Other infrastructure is maintained for client support, such as the use of aggregation logic and reporting to help investment managers reconcile their positions.
- **Record Date Capture:**
- Entitlement Reconciliation: Process begins with a basic stock record on the broker-dealer books, but infrastructure identifies where shares are held, registration of shares, margin positions, etc., to ensure that all of the customer's positions are captured.
 - Filtering: Recognition of shares held in the customer's name directly as opposed to the street name.
 - Pre-reconciliation: The use of lottery programs to reduce customer margin positions (not fully paid for securities) to match the voting entitlement of a broker-dealer based upon securities lending or short positions.
 - Preference management: The application of customer preferences, such as electronic delivery, mailing re-direction and aggregation, house holding, etc., and applying these instructions to the file. These are handled through 2 main channels:
 - Mailbox – Receipt of records for the vendor that allow for connectivity for display on customer websites and links for voting;
 - Special Files - Supplemental files used in the process, as well as for support in special circumstances.

3. Oversight / Supervision

- **Vote Reconciliation:** Whether a broker-dealer is a pre-mailing reconciliation broker-dealer, or a post-mailing reconciliation broker-dealer, they have to review file transmissions and records to ensure they are complete and that all voting positions are accounted for. This process is needed to allow the customers to vote all shares which can be held by broker-dealers in various

locations, who may have different methods to obtain voting entitlements, with some more automated than others. **Scenarios where**

- Multiple custodians (Canada, Euroclear, various custodian banks);
 - Registered form, need to vote physical card;
 - DTCC did not pass the position as anticipated, or re-registrations did not occur within the expected timing from the Transfer Agent;
 - Broker-dealer omnibus proxy due to fails of delivery in time for record date.
- Broker-dealers build reconciliation files and reports for validation, which are downloaded on a daily basis, to research position balances and potential exemptions, such as those items where the broker-dealer is reflecting more shares than what DTCC is showing.
- **Post Reconciliation:** The review of pending over vote reports daily, and making the necessary adjustments for final voting. Reasons for adjustments typically are a result of multiple locations, timely receipt, and recording of position by the tabulator. Once an associate has identified the issue and adjustments need to be made, the associates will access vendor systems and make the necessary adjustments. In addition, the associate will document the resolution for supervisory review and approval.
 - **Due Diligence / Supervision:** Regulators, as well as SROs like the NYSE, require that broker-dealers supervise their vendors. Broker-dealers can contract with vendors to handle the physical work of proxy, but the responsibility to comply with the rules remains with the broker-dealer. Supervision models are different for every broker-dealer, that use a combination of exception reports, random selections of jobs, site visits, contacts by phone, and performance reporting. Every time a broker-dealer looks at the vendor's system, it examines the entire job for timeliness, and the overall look of the job. Additionally, there are broker-dealer specific audit firm engagements with respect to agreed upon procedures.
 - Oversight of SLA and Regulations – The engagement of the above to ensure that the vendor is performing stated SLAs and operating within the guideline of the regulations.
 - Legal, Compliance, and Audit Involvement – The broker-dealers' internal auditing groups routinely engage the proxy department to ensure compliance with policy and procedures. Special situations may require engagement of legal or compliance groups often as a result of customer or issuer requests, such as wishing to nominate a director to the board.
 - **Technical Risk Review** – In addition to operational oversight, broker-dealers review the vendor's information security and business continuity planning infrastructure on a regular basis.

- Broker-dealers also have oversight responsibilities around voting, such as vote position balancing, over voting services, and share facilitation. They are described in detail above.
4. **Client Service:** Third party vendors provide proxy services for hundreds of broker-dealers, who each have thousands of clients. There is no direct contact between broker-dealer clients' and the vendor meaning that broker-dealers provide *all* customer service around proxy inquiries.
- The number of client inquiries managed by the broker-dealers varies. Broker-dealers have access into the vendor's systems, so that these inquiries do not all result in a call to them. Inquiries received by broker-dealers, mostly require some proxy expertise, therefore, the broker-dealers provide instructions to branches on handling other issues.
 - Broker-dealers typically add resources to support proxy season. This may include extensive training and re-fresher material, as well as courses which are utilized with support staff and branch (customer facing) associates for support of customer questions and the client experience.
 - Topics covered in customer service inquiries include electronic delivery, late delivery of materials, notice and access, voting cutoffs, and lost control numbers. Other topics covered may include:
 - Legal proxies;
 - Duplicate materials that a broker-dealer will request so that proxy material may be sent directly to clients, if they have not received their proxy package. If no additional material is available, requests are sent directly to the issuer;
 - Notice and access fulfillment requests - Broker-dealers will request hard copies of materials for those clients who receive information through notice and access;
 - Inquiries/complaints about solicitor phone calls – Explanation of rules that allow this practice;
 - Split and partial voting – Primarily in support of omnibus accounts in retirement, managed solutions, other entities and clearing brokers;
 - Support for investment managers, especially in reconciling the proxy they receive to the voting entitlement on their records;
 - 401K voting – Complicated by the contractual arrangements between the company and the broker, with a focus on how un-voted shares are handled;

- Special handling meetings – an example are special-purpose acquisition companies (SPACs), which include both the voting and physical presentation of shares, with every instruction reviewed and signed off by a manager;
 - Shareholder demands – Shareholders wish to take an action that is reserved to record holders. Broker-dealers then need to draw up legal documents identifying the shareholder, stating the request, and obtaining a signature from the record holder, typically DTC;
 - Consents with payment – Issuer is willing to pay security holders a fee if they will agree to amended terms. Customer must be made aware of the offer, and they are tabulated like a regular proxy. After the matter is settled, payment must be distributed to accounts who participate in the offer;
 - Consents – Due to the nature of a consent vote requiring physical submission of a ballot, broker-dealers often field an increased number of queries from Clients;
 - When client voting cards are sent to a broker-dealer instead of the address provided, the broker-dealer will forward these votes to the vendor;
 - Broker-dealer will answer general questions regarding the meeting;
 - Customer request for attendance to a meeting;
 - Voting Instruction Form ('VIF') Rejection – Broker-dealers reach out to Clients to solicit new votes for any VIF rejected from their vendor;
 - Dissents – Typically after a special meeting, a merger will occur within a specified period of time. Shareholders often have the right to hold their shares back from the merger, and then petition the courts to have the shares appraised. Broker-dealer proxy services staff work with their Reorganization Department and DTC to segregate the shares so they are not presented in the merger.
- **Proxy Education:** Broker-dealers invest time and infrastructure to provide education to their customers. This may be in the form of both proactive campaigns, such as reminders and tools prior to the proxy season, which address commonly asked questions and provide information to make the voting process smoother, and customer service to address questions and comments as they arise.
- **Websites:** Some broker-dealers utilize EBIP or have other information available for customers. The development provides real-time links to proxy material as well as the convenience to vote from the site, with single log-in technology making it easier on the customer to retrieve material and complete their voting.

- **Educational Materials** – Educational material, including best practices and frequently asked questions, can be distributed as part of regular mailings or linked within websites and voting tools, such as EBIP, with further links to educational pages, such as the SIFMA Proxy Resource Center.

- **Issuer Assistance:**

- **Un-voted Shares** – Issuers may reach out to broker-dealers if they are experiencing low voting on specific proposals, whereby broker-dealers may be able to assist by encouraging clients to vote per local policies and procedures. Such requests are most commonly from fund companies with special proposals on the ballot. While issuers can perform multiple mailings, broker-dealers may assist the issuer by distributing internal communications to clients or reaching out to larger shareholders or their representatives to remind them about a proxy campaign.
- **Small issuers** – Small issuers are not required to follow the standard procedures, but are still publicly owned companies with proxy obligations. A client may contact the broker-dealer if they would like to vote or attend a meeting. The broker-dealer must contact the issuer to obtain documents, and execute a vote manually.

5. Record Retention: Broker-dealers are required by various regulations to retain all proxy solicitation records, including the physical search requests through file transmission and the voting records. In addition to these regulations, issued by both SROs and federal agencies, broker-dealers must also comply with rules specific to the protection of client records and vendor oversight. The lengths of time for storage vary by regulation, but the minimum requirements for storage is three (3) years, with a requirement to have the first two years of records easily accessible.

- **IT File Storage**

- **Daily record-day file** – Retention of search request files and customer records used to build client entitled positions as of the record date. These files are used in the solicitation process. These files include the records for Proxy voting engagements as well as general distribution records for annual or other related reports. Regulations require the storage of relevant dates in the process, the names of customer's to whom material was sent and all voting instructions and summaries.
- **Customer preferences** – The retention of client directed instructions for the delivery of material to various address, including temporary residences or re-direction to authorized manager as well as consents for electronic delivery, house holding and Notice & Access.

- **Records Management**

- Reconciliations – File management and review records that ensure that all entitled customers are included in a distribution and solicitation and that all voting rights are obtained. Documentation includes work obtained in the oversight responsibilities of any vendors and the mailing process.
- Evidence of Supervisory Review – Proper documentation and evidence that all applicable reconciliation was performed and appropriately signed off by an authorized individual within the firm.
- Client requests - This includes originals of all communications received and copies of all communications sent relating to such a solicitation. Records are reviewed for accuracy at various stages and are evidenced for proof.
- Mail – Broker-dealers have a process to review physical mail on a daily basis and to review issuer directed mailings, returned mail and client copies.
- Broker-Dealers are responsible for both maintenance and storage of customer files. Typically, they manage this responsibility through a third party vendor that specializes in solutions for records management, data backup and recovery, document management, and secure shredding.

Other broker-dealer responsibilities include when Proxies are Received Directly from Companies:

Broker-dealers may also handle proxy mailings for companies whose proxies are not processed by third party vendors, including both issuers who will not work with a vendor and private placements. These include but are not limited to small issuers, Canadian issuers, ADR programs, private banks, and physical holdings. The processes to support these mailings include:

- An associate will retrieve the stock record position for that company based on the given record date.
- An associate will determine the client eligibility and compile the names, addresses and the share quantities for each client as of the record date.
- An associate will respond to the company and request the appropriate quantity of proxies needed to do the mailing, or the company is already aware of the client count and provides broker-dealers with the proxies to be mailed.
- If the company decides to forward the material to broker-dealer, then the broker-dealer will mail the proxy packages to the appropriate clients. This is usually special handling for files to a different mailing venue, or even manual distribution through local mail rooms.

- If the company decides to mail directly to the clients, the broker-dealer will provide a list of accounts, addresses and share quantity to the company so that they may perform the mailings.
- Companies require broker-dealers to compile the votes and send them with a cover sheet authorizing these votes back to the company. Broker-dealers need to manually tabulate votes from customers for submission of a single consolidated instruction.

Generic Material:

Some issuers do not recognize the nominee system and will send a single copy of material to the registered holder, typically a depository or custodian bank. The registered holder will make the copy available and broker-dealers need to review and identify the impact. Broker-dealers will typically duplicate the material themselves if the issuer will not provide additional sets for the solicitation. These can include Bankruptcy and default notices where court rules often limit reimbursement of costs.

Strategic Development:

Broker-dealers also dedicate resources to maintain a continuous focus on development of technology and processes to improve the client experience and support a straight through efficiency proxy voting service.