

# NYSE'S RULE 452 *in a Nutshell*

BY LOIS YUROW

**ON JULY 1, THE SEC APPROVED AN AMENDMENT TO NYSE RULE 452 THAT WILL PROHIBIT BROKERS FROM VOTING THEIR CUSTOMERS' SHARES IN CORPORATE ELECTIONS WITHOUT INSTRUCTIONS. THE AMENDMENT GOES INTO EFFECT AS OF JANUARY 1, 2010.**

## Rule 452 in a Nutshell

As IROs are aware, most shares in public companies (roughly 85 percent) are held in “street name” — legally owned by brokers on behalf of their customers, the beneficial owners. Under current rules, if a broker does not receive voting instructions from a beneficial owner, the broker can use its discretion to vote that customer's shares on any routine matter on the proxy.

Rule 452 does not define “routine” matters. Instead, it specifically prohibits brokers from voting without instructions on 18 non-routine items, including contested elections and shareholder proposals. Uncontested board elections — even those that involve “vote no” or withhold campaigns — traditionally have been considered “routine.” Once the new amendment is effective, brokers will not be permitted to vote without instructions in *any* board election.

## Behind the Amendment

Advocates of the Rule 452 amendment argue that uninstructed broker votes distort elections. Specifically, brokers typically vote in line with management's recommendations, which creates the appearance of greater support than may actually exist. Similarly, broker votes can overwhelm genuine shareholder votes that oppose management. In addition, advocates argue that a corporate board is too important to be elected by parties such as brokers who have no economic interest in the company.

## Impact of the Uninstructed Broker Vote

With such a large percentage of corporate stock in brokers' hands, the numbers involved in discretionary voting can be significant. According to Broadridge, uninstructed brokers voted 19.1 percent of corporate shares in 2009.

But how much of an effect do discretionary votes really have? Broadridge analysis shows that, if there had not been discretionary voting in 2007, the number of directors who would have failed to obtain majority support that year would have almost doubled — from 74 to 142. Similarly, 612 directors would have had 25 percent or more withhold or “no” votes, compared to 452 with discretionary voting. On the other hand, broker voting only tipped a majority vote election for two directors (out of 7,812) that year.

## Implications of the Amendment

For IROs, the implications of changes to Rule 452 are *huge*. Here are seven issues you and your colleagues need to think about before the next proxy season.

**Electronic delivery.** As companies tested electronic delivery for proxy materials in 2008, retail participation in corporate elections declined by an average of 51 percent. In the past, brokers likely would have voted on behalf of those less-than-diligent investors. If your company is concerned about low participation rates, start rethinking your electronic delivery strategies.

**Expenses.** Expect your solicitation costs to increase as you try ever more creative ways to reach your investors and encourage them to vote. Of course, you can only contact your Non-Objecting Beneficial Owners (NOBOs) directly, and if you hound them they may decide to become Objecting Beneficial Owners (OBOs), so be judicious. The SEC received several comment letters — including one from NIRI — arguing that the Rule 452 amendment should be coupled with changes to the rules governing how public companies communicate with investors, but that issue was punted to a future rulemaking.

**Investor education.** IROs should develop investor education programs on two fronts. First, OBOs need to under-

stand that, since their status prevents you from contacting them directly, they should check your Web site periodically to be sure they don't miss anything that might influence their vote. Second, and more critical, all of your investors need to understand that, come January 1, 2010, if they fail to vote their shares or to give voting instructions to their brokers, their shares will be counted as “no” votes. For years proxy materials have assured investors that their brokers will vote their shares. It will require some clear and conspicuous language to convince them this is no longer true.

**Quorum.** If brokers cannot vote, and retail investors will not vote, is there a risk that you will not achieve a quorum in your next election? Certainly smaller companies without a substantial volume of institutional ownership need to consider that possibility. The solution is to ensure that at least one “routine” matter, such as ratification of the auditors, is put to a vote at every shareholder meeting. Brokers can still vote without instructions on these questions; that vote will ensure a quorum for the rest of the meeting.

**Majority voting.** In the past few years, many companies have replaced plurality voting standards with majority voting. If your company is one of those, your concerns about voter turnout are about to be magnified. If you have not adopted majority voting and hold off to see what kind of participation you can expect without the broker vote, you may have a tricky public relations issue on your hands.

**Influence of proxy advisers.** Discretionary voting only affects the retail vote. Institutions regularly participate in corporate elections, so the proportionate



Lois Yurow

impact of their vote is about to increase. Consequently, it is crucial for companies to understand the voting policies of their mutual fund investors, and the voting guidelines of the proxy advisers to their other institutional investors. The SEC intends to study institutions'

use of proxy advisers and to consider whether that relationship warrants more regulation, but did not think it necessary to hold up the Rule 452 amendment in the interim.

**Influence of activists.** Not all retail investors are relaxed about their corporate civic duties. You can expect participation from anyone who harbors a gripe, has submitted a shareholder proposal, has nominated a board member (assuming some form of proxy access is adopted), or has otherwise decided to be heard. IROs can no longer count on broker votes favoring management to dilute activists' impact, so your outreach to these investors will take on new importance.

## Conclusion

The SEC articulated several legitimate reasons for amending Rule 452 — particularly the goal of ensuring that voting was in the hands of the most interested party. Now it falls to IROs to make each interested party understand how voting will benefit the company — and each investor's — own interests. IRU

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### WILL COMPANIES HAVE TO REPORT VOTING RESULTS SOONER?

Less than two weeks after banning broker discretionary voting in director elections, the SEC proposed a rule amendment that would require public companies to report the results of shareholder votes sooner than they do now.

Under current rules, companies use their quarterly (10-Q) and annual (10-K) reports to state the results of any shareholder vote that took place the preceding quarter. As a result, months can pass before investors learn how many votes were garnered by a shareholder proposal or a stock option plan.

The SEC proposes to shift this reporting requirement to the current report on Form 8-K. Specifically, proposed new Item 5.07 would require disclosure on Form 8-K within four business days after the end of any shareholder meeting involving a vote. The proposal offers some leeway for contested elections, where results may not be tabulated within four days.

This relatively simple amendment was part of a larger package of governance-related proposals, so it is not clear when the SEC will put it to a vote.

— Lois Yurow