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SEC's Plan to End Broker Vote Rule is a Huge Win for Institutional Investors

By Laura Gundersheim

The Securities and Exchange Commission ("SEC") recently announced plans to eliminate a longstanding rule that allows brokers to vote on their clients' behalf in director elections; the so-called "Broker Vote Rule." Since 1937, the SEC has permitted brokers to vote their clients' shares. Typically, those brokers voted in favor of entrenched managements and boards. The SEC's rule change will give institutional and activist investors significantly more power to determine who sits on corporate boards. Until now, uncontested director elections have been considered routine. The SEC's proposed rule change states that such elections are no longer routine items and brokers cannot vote the stock either way without shareholder instructions. Since many small shareholders simply do not vote in elections, institutional and activist shareholders who do vote will have significantly more power to effectuate change.

The issue of broker votes is significant because an estimated 70 to 80 percent of U.S. company shares are held in "street name" and managed by brokers. Under the current rules, if the underlying beneficial owners fail to provide voting instructions within 10 days of a company meeting, then the brokers are permitted to vote their shares on "routine matters," including uncontested elections, as they wish. During 2008, 16.5 percent of shares were voted with broker discretion, according to Broadridge Financial Solutions. Brokers overwhelmingly vote for management, on the theory that any shareholder who opposed the company's position would have given the brokers explicit voting instructions. In the U.S., about 80 percent of investors' stocks are held at brokerage accounts.

The change to the Broker Vote Rule has long been sought by large shareholders and activists who want to make it easier to vote out under-

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performing boards or pass proposals geared toward increasing good corporate governance and instituting executive pay caps at companies. The rule change, first proposed in 2006, is slated to take effect before the 2010 proxy season.

The Broker Vote Rule has gained added importance in recent years as many large, U.S. companies have adopted provisions that require board nominees to receive a majority of votes cast in uncontested elections. While most directors receive minimal opposition, discretionary broker voting can blunt the effect of "vote no" campaigns.

This rule change is the first of what is expected to be a series of changes under way at the SEC. Although the broker vote change was first proposed in 2006, it stalled under former SEC Chairman Cox, and was never finalized. Reviving the broker vote proposal was one of SEC Chairman Schapiro's first moves since taking the helm in January. The issue was delegated to the SEC staff to approve and did not require the five commissioners to weigh in.

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