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# Communicating with Retail Shareholders: How Much Can an Issuer Say Outside the Proxy Materials?

The past several months have seen a resurgence in the years-long debate over proxy mechanics. One focus of the debate has been the desire of issuers to have more direct channels of communication with their retail shareholders, and some perceived frustration with their ability to do so in an efficient manner.

In response to questions we have received on this subject, we have prepared the below answers in order to better explain the SEC's proxy communications rules and how they operate. In our previous Q&A document, Frequently Asked Questions Regarding the SEC's NOBO-OBO Rules and Companies' Ability to Communicate with Retail Shareholders, we addressed the underlying mechanics of issuer-shareholder communications. In this Q&A we focus on the SEC's rules governing the substance of such communications.

## What are the SEC's proxy communications rules?

The SEC's communications rules govern the content of an issuer's proxy communications with its shareholders. They seek to prevent issuers from soliciting proxy votes by use of materially incomplete and/or inaccurate communications. Because the communications rules focus on communications that influence proxy voting, they only apply to solicitations. As defined in the rules, a "solicitation" is any communication that requests a shareholder to vote in favor or against a matter, or to abstain from voting on a matter.

Many communications simply do not bear on a current or anticipated proxy vote, and they accordingly are not solicitations. Hence, their content is not regulated under the proxy rules (other than the general anti-fraud provisions). A letter from the CEO, for instance, discussing the current economic climate and its impact on the company's business, would not ordinarily be a solicitation. However, a letter urging shareholders to support an anticipated company-sponsored "say-on-pay" proposal ordinarily would be a solicitation because it seeks to influence the outcome of an anticipated vote. As is the case with any public statement, issuers should still be mindful of Regulation FD if the communication includes material, non-public information.

## Are solicitations off-limits in issuer-shareholder communications under the proxy rules?

No, not at all. Under existing rules, issuers can communicate freely with all of their shareholders, even on matters that are—or are expected to become—proxy statement proposals, and which are accordingly solicitations. That is because an exemption allows issuers to communicate with shareholders on such matters.

In 1999, the SEC amended Rule 14a-12 to permit issuers to communicate with their shareholders orally or in writing about a matter that the company expects to be presented at the next annual meeting. This is the exemption upon which issuers often rely today in communicating with their large institutional holders.

In most cases, the company relying on the exemption must file with the SEC any written material that it uses, and include some legends. For example, an issuer may, if it wishes, communicate during the year with its shareholders on its compensation principles and strategies, in anticipation of a say-on-pay proposal to be presented at its next annual meeting. If a company sent out a letter from the CEO along these lines, it would have to file the letter at the time the letter was distributed.

## Even if an issuer has wide latitude in communicating with shareholders, how can the issuer do this if it does not know the identity of many of its retail shareholders?

Most issuers should have access to the names and addresses of a large proportion of their retail shareholders. This includes both:

- registered shareholders, whose holdings are typically reflected on the books of the issuer's transfer agent; and
- "street name" shareholders, who have not objected to the disclosure of their contact information to issuers, commonly referred to as "NOBOs."

The number of registered holders and street name shareholders who are NOBOs will vary from one company to the next, but they typically represent a sizable proportion of a company's retail shareholders. According to proxy industry participants, approximately 75% of all street name retail shareholders are NOBOs and approximately 20% of all shareholders are registered shareholders.

## Is it really burdensome to include OBOs in a communication if an issuer wants to communicate with all shareholders at the same time?

The debate over direct vs. indirect communications boils down to who chooses the intermediary used to make the distribution. If the issuer has direct contact information for a shareholder—as in the case of a NOBO—it can hire its own distribution agent for informal, interim communications. If it does not have direct contact information—as in the case of an OBO—it must use an intermediary that is chosen by the broker.  So, either way, the issuer would normally be using an intermediary.

What about cost? There is some appeal to the notion that the issuer's ability to chose a distribution agent generates more competition, and hence, lower prices. On the other side of the debate are the economies of scale that can be achieved through consolidation—and indeed the SEC cited such economies in the 1980s when it encouraged appointment of a single agent for maintaining the NOBO databases. In all events, distributions made through a broker's intermediary are at prices set by the NYSE. A communication that is "voluntary," in the sense that it is not compelled by SEC rules, is an "interim" distribution and costs 15 cents per mailing, plus a 10-cent fee for electronic distributions. We have no information on how these prices compare to the prices charged by other agents that might be selected by an issuer.

Because of their role in making proxy distributions, brokers' intermediaries have generally collected consents to electronic delivery of proxy materials—which permits them to send a good proportion of a distribution electronically—as well as databases reflecting when a single distribution may be made for the benefit of numerous holders (e.g., when it is permissible to send one set of materials to a single household). Electronic communications cut down on some of the big expenses of shareholder communications—namely, printing and postage costs.

## Is it permissible to distribute a communication only to NOBOs and registered shareholders?

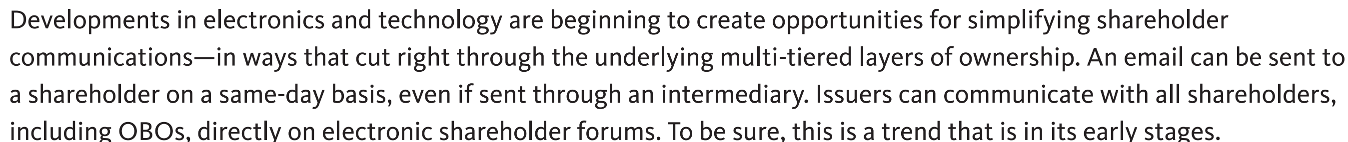
There is nothing in the proxy rules that forbids communications with some, but not all, of an issuer's shareholders. Many issuers routinely communicate with only a handful of institutional holders. However, years ago, after adopting its NOBO-OBO rules, the SEC made statements encouraging (but not requiring) issuers to communicate with all of their shareholders rather than just one or more segments. While issuers should endeavor to communicate with all shareholders in an equal manner, the SEC's statements on the subject almost certainly have less force today, given the alternative means for shareholders to access information that were not available back then—e.g., the issuer's company website. In all events, for communications that are not compelled by SEC rules, and are not otherwise material, it is hard to argue with an issuer's decision to contact only those shareholders who have evidenced a desire to be contacted directly by the issuer—the NOBOs.

## Why is the shareholder communications system so complicated? Wouldn't it be better to simplify the system?

It is not so much the proxy system that is complicated, but rather the underlying clearance and settlement system upon which the securities markets rely in clearing large volumes of trades. It includes a system of multi-tiered ownership, where technical stock ownership resides with depositories such as the Depository Trust and Clearing Corporation (DTCC). This system, which separates record ownership from actual beneficial ownership, allows multitudes of trades to be netted among brokers without having to deal with individual exchanges of single stock certificates.

The shareholder communications system is important, but it is secondary to the efficiency of the stock markets. Accordingly, channels for shareholder communications have to piggyback on a share ownership structure that was designed to serve a different purpose—market trading.

Developments in electronics and technology are beginning to create opportunities for simplifying shareholder communications—in ways that cut right through the underlying multi-tiered layers of ownership. An email can be sent to a shareholder on a same-day basis, even if sent through an intermediary. Issuers can communicate with all shareholders, including OBOs, directly on electronic shareholder forums. To be sure, this is a trend that is in its early stages.



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