

# **SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.**

SEC Wire

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## **Body**

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SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

SEPTEMBER 13, 2018

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ADVISORY COMMITTEE.

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KARA STEIN, COMMISSIONER, SEC

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HESTER M. PEIRCE, COMMISSIONER, SEC

[\*] (CORRECTED COPY - CORRECTS SPEAKERS LIST FORMATTING)

SHEEHAN: I'd like to call the meeting to order. So if people can take their seats, we'll start in about one minute.

Oh, good morning everyone and welcome to the September 13th meeting of the Investor Advisory Committee. Before I turn it over to recognize the Chair and some the other Commissioners to make some comments, I want to see who we have on the telephone from the Committee. Is Elisse on the phone?

WALTER: I am.

SHEEHAN: Great. Paul Mahoney, are you with us?

MAHONEY: Yes, I am.

SHEEHAN: Good morning. Bill Lee, are you also participating by phone? Not yet.

And, Barb Roper, are you on by telephone? All right. Is there -- is there anyone else on the phone who wants to be recognized before I turn it over to the Chair for some opening comments? All right.

HOLMES: Anne, this is Stephen. Also I'm on the video conference.

SHEEHAN: Okay. Stephen Holmes is also on. Okay, great. All right. Thank you all.

So, Chair Clayton, good morning. Nice to see you.

CLAYTON: Great to see you. Thank you. Good morning, everyone. I want to welcome our -- or should I say welcome back Commissioner Elad Roisman. It's s your first Investor Advisory Committee meeting.

Elad was confirmed just last week as the 98th Commissioner of the SEC. We met many years ago when you first worked at the Commission. And I am certain that Elad will again make a lasting contribution to the work of the Commission. Thank you for coming back. Congratulations.

Turning to today's business, I'm delighted that the Committee will focus this morning on our proxy voting infrastructure. We recently announced the staff will hold a roundtable on the proxy process later this fall. It is clear to me that accuracy, transparency and efficiency in the proxy system both and still and are critical to confidence in our shareholder governance process.

In 2010, the Commission -- I haven't got to the good part yet.

(LAUGHTER)

In 2010, the Commission issued a concept release that solicited feedback on the proxy process. A lot has changed in our market since then, and I commend you for taking the time this morning to discuss how the proxy voting infrastructure could be modernized or improved.

In the afternoon you will discuss the Commission's s proposal to conduct a transaction fee pilot and NMS stocks. The pilot is designed to generate data to help us meaningfully analyze the effects of exchange fees and rebates on

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

order routing behavior, execution quality and our market structure generally. In my view, a pilot of the type proposed should provide the Commission with data that will help us make better informed and effective policy decisions. I look forward to hearing your perspectives on the proposal and any recommendations you may have in this area.

Finally, the schedule for this afternoon also includes a discussion of the growth of passive investing and its implications. Many say that passive investing provides a low-cost, low-maintenance way to obtain diversified investment exposure.

A meaningful portion of market commentators also point to benefits of active management. Market analysts also posit that risks may be amplified as a result of concentration in passive strategies, and there are questions around how passive funds should approach engagement with companies on the one hand and engagement with their investors on the other hand. This issue also applies to funds that are actively managed and may dovetail with your proxy process discussions of the morning. In short, I commend you for having a connected agenda.

I hope you approach these issues, as I try, to with a view toward what is best for the long-term interests of our retail investors. For example, those who are investing monthly in their retirement accounts to fund expenses that may be years away.

You have an interesting impact agenda ahead of you. Before I let you get on with it, I want to thank all of you for your service to the Committee. You have very busy schedules, yet you take substantial time to share your knowledge and expertise for the betterment of investors and our markets.

Also, I have a -- a supplement to my remarks that I will put in the area of being FD-compliant. This morning I issued a statement reiterating, and the statement is similar to statements issued by my colleagues at other financial regulators reiterating that SEC staff use are nonbinding and create no enforceable legal rights and obligations. My statement also notes an ongoing effort by our divisions and offices to review prior staff statements and documents and consider whether they should be modified, rescinded or supplemented in light of market or other developments.

Also, this morning in connection with this review in the upcoming roundtable on proxy process, the Division of Investment Management issued a statement withdrawing two 2004 letters, one to Egan-Jones Proxy Service and one to Institutional Shareholder Service. The Egan-Jones letter is a May 27, 2004 letter, the Institutional Shareholder Services, Inc. letter is a September 15, 2004 letter.

I look forward to continuing to discuss these topics. And as noted, the staff is having a roundtable on these issues, and I look forward to -- I have some of my commissioners here. I can say this in an open forum the Commission engaging on these topics and moving forward in light of our current market structure.

Thank you, Anne.

SHEEHAN: Great. Thank you, Chair Clayton.

Commissioner Peirce, good morning. Nice to see you.

PEIRCE: Good morning. Nice to be here. Thank you all for being here. I want to welcome Commissioner Roisman who, I think, you all find to be a wonderful advocate for investors. I look forward to working with them. And I'm sure that we will benefit greatly from his wisdom.

I want to thank you all for your efforts through the -- through the time between meetings, which is evident in the agenda that's before us today. It looks like a very useful agenda for informing us as well as you, so I look forward to the discussions and thank you for being willing to brave the hurricane to -- to travel to be here. Thanks very much.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SHEEHAN: Thank you. And, Commissioner Roisman, welcome. We're happy to have you with us as the Chair and Commissioner Peirce said welcome to the Commission.

ROISMAN: Still need to learn how to push the button.

SHEEHAN: Yeah, you're Okay.

CLAYTON: It's not in the training manual.

ROISMAN: Yeah, it really isn't.

(LAUGHTER)

Thank you everyone and good morning. I wanted to go, first of all, thank both Chairman Clayton and Commissioner Peirce for their kind introductions. Thank you all for being here. As I'd like to echo their sentiment as well, I know you guys all have day jobs and really appreciate you volunteering and sharing your thoughts, experiences and wisdom. I look forward to today's discussions, and I look forward to working with you in the future.

SHEEHAN: Thank you. And the other two, I know Commissioner Stein is on her way. So, at some point, we'll get opening comments from her and Commissioner Jackson will be joining us, I think, around the 10 o'clock hour, so we'll also have the opportunity to hear from him.

So, Chair Clayton, I appreciate the heads up -- ooh, there she is.

STEIN: Hello.

(LAUGHTER)

SHEEHAN: Your -- your timing is perfect. This is good. So good morning, Commissioner Stein. Despite the hurricane you get to where -- yeah, the traffic in D.C. I remember that from my days here, yeah. So good morning. Welcome.

STEIN: Thank you. Am I actually supposed to be speaking now?

CLAYTON: I -- I can -- I can take up ...

STEIN: Did you do your ...

CLAYTON: ... I can take up some time while you're ...

STEIN: ... did you do introductory remarks?

CLAYTON: I did do and -- and you're -- you're next, but I -- I -- I should have said this in my remarks and did not. I have looked down through the panelists we have today and it's -- it's -- it's truly an extraordinary group. So I -- I know some of you and -- well, I know some of you for a long time and know some of you more recently. And I congratulate the Committee for having such a -- such excellent panelists here. So I hope you aren't about to say that.

(LAUGHTER)

STEIN: No, but I'm going to second that. I want to welcome everybody to today's Advisory Committee meeting. I assume that you welcomed our new commissioner.

(LAUGHTER)

But I would also like to welcome our new Commissioner, Commissioner Roisman to his first Investor Advisory Committee meeting. And I'm going to do my normal -- I really, really do appreciate how busy you all are and how

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

much time you take out of very busy schedules to do this pro bono. So thank you again to all of you for coming and -- to Washington and spending time with us.

I'm really excited about today's panels and the morning panels focusing on shareholders in public companies, in particular, and how they can exercise their vote. The proxy process allows investors to make important decisions about the corporations they own, such as electing directors who represent their interests and making their views known on a number of matters that affect companies. I think that's a two-way street. The companies also, by putting things on the agenda, now are able to get information from their investors about the direction of the company.

Yet, the proxy process is far from ideal. I think, for me, one of the things that's come home is despite dramatic advances in communications and technology, it's -- it's still service downing to me that shareholders who physically go to meetings have greater sort of rights and opportunities than those who vote by proxy. Shareholders who do not attend meetings, which includes a vast majority of institutional and retail investors may vote using proxy cards that often do not list all of the board nominees or all of the people running for the board. And I think this is a distinction that should not exist in the digital age where people can attend all sorts of events virtually.

In fact, in some countries such as Estonia, you can even vote in government elections from almost any place in the world. I was talking to someone who is Estonian and he voted from Australia. In his Estonian government election on his cell phone.

Recognizing this disparate treatment, the Commission proposed amendments to its rules to allow universal proxy cards. This has been about two years ago. Under this proposal, all investors will be treated the same regardless of their geographic location. Unfortunately, it's, as I said, a couple of years since the proposal went out and the Commission has not yet had the opportunity to vote on the final rule, I think it is time for the Commission to move forward on this issue. And I certainly would love to see Chairman Clayton do so.

Another topic for this meeting is how we can harness the power of innovation to strengthen the means by which shareholders and corporations communicate. Block chain technology offers new possibilities to maximize shareholder engagement to the benefit of both companies and its investors. The proxy process can also be improved by focusing on the so-called plumbing. There's no question that a proxy system is inefficient and it can lead to uncertain or erroneous results. For instance, just last year, one company's vote count swung back and forth for months. We can and we must do better for our investors and for our companies. The Commission should embrace technology to improve the accuracy, transparency and the efficiency of the proxy voting system. In addition to the issues related to the proxy process, the Advisory Committee is going to hear from panelists on the growth of passive investing.

Over the last decade we've seen a rapid growth in passive investing through index mutual funds and exchange traded funds. The movement from actively managed investments to passive investments in both equity and bonds may have long-term impacts on the securities markets. However, I think market participants and the regulators are still grappling with the implications of the seismic shift.

For example, indices created today are very different than those that were created several decades ago. In fact, the underlying methodologies can be incredibly complex and many providers keep their proprietary formulas secretive. When complexity is combined with opacity, we must proceed with caution. We should proactively examine the possible effects on both security-specific pricing and the flow of funds dynamics that may affect the overall marketplace if passive investing funds continue their growth trajectory.

As always, I look forward to hearing from you today and thank you.

SHEEHAN: Thank you, Commissioner Stein. Thank you all. And we also are looking forward to the panels today.

And I think, Chair Clayton, you're right. As we put the two together, we realize there was a link between the growth of passive investing and the exercise of governance rights and the issues related to corporate governance in their voting on the proxies.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

CLAYTON: Yes. And to Commissioner Stein's point and your point, today's panels are focusing on infrastructure. The Division of Corporation Finance has announced these roundtables, but, you know, these are dynamic issues. Infrastructure and regulation go together, so people should feel free. I know this group feels free to speak its mind, so you should feel free to speak your mind.

SHEEHAN: Thank you, thank you. And I appreciate the comments on the -- the guidance letters that you took action on. I mean, today our focus will be really on some of the -- the plumbing, the infrastructure issues, but I know through your roundtable and others, there's a lot of interest in the whole proxy advisory issue as well as the other items, which are identified in the release in terms of announcing the roundtable. So thank you for that.

Before we get started with the first panel, we've got a couple of sort of housekeeping. So we have the minutes for the Committee. You should have the minutes before you. Are there any changes, edits to the minutes? If not, we will entertain a motion.

We have a motion and a second? We have a second to approve the minutes. All those in favor say aye.

(UNKNOWN): Aye.

(UNKNOWN): Aye.

SHEEHAN: Any opposed?

(UNKNOWN): Aye.

(UNKNOWN): Aye.

(UNKNOWN): Aye.

SHEEHAN: Right. All right. A little delayed, but that's good. The minutes are approved, yeah.

(UNKNOWN): (Inaudible).

SHEEHAN: We'll take it as an aye. I didn't hear any no, so ...

(UNKNOWN): (Inaudible).

SHEEHAN: A delayed yes, I guess, is still a yes. And then before I introduce the first panel, I want to recognize the students from Seton Hall who were in the audience. Seton Hall has one of the law school clinics that this Committee has heard about over the past few years, so I don't know if the students would like to stand up. We want to welcome you to the Investor Advisory Committee.

(APPLAUSE)

Yeah. Welcome. Thank you for being here and joining us today.

So this morning, as the commissioners had recognized, we'll start with the first panel. As has been said, it really -- the first panel -- and we have two -- two panel sessions on the topic of proxy plumbing.

I am very personally very excited about this issue. From my 10 years, it stirs a lot of time and attention spent on proxy plumbing and the voting as a fund that own about 8,000 companies. We've spent a lot of time on proxy voting. We voted probably every year over about 70,000 different issues, so a vested interest. So I can only imagine all of the others, some of the index funds that we've talked about and others, and the number of votes that we take. So we all care very much about the proxy voting system. And the integrity of the system really goes to the heart of our corporate governance activities.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

The owners of the companies exercising their right to vote, the companies themselves getting the input from the shareholders, making sure that they can conduct their meetings and that they have quorum, and that the important thing is that all of us who are voters feel that the votes are counted, and we understand what that process is.

As we proceed today, we'll need to ask ourselves what is it we want out of a good proxy voting process. From my perspective, we want transparency. We want accountability so that I know the votes are counted. We want hopefully efficiency so that it is easy to do and we want to be able to understand the process.

I think issuers, as I said, they need to make sure that they make quorum and that they're getting the necessary votes to approve their business items that they have, and that also as they need to get the vote out that they can communicate with their shareholders easily on communicating with them and sharing with them the views of management. So we have to ask ourselves, is the current process working as was intended or are there ways that we can improve it? You know, does it serve the interest of investors? Does it serve the issue -- the interest of the issuers? And if not, what more can be done?

We will also hear this morning from the intermediaries in this process and the critical role that they play in facilitating the proxy voting process. You know, are these intermediaries working to facilitate the ease of voting process? Are they working to ensure that the -- the -- the accuracy of the vote, the efficiency of the votes and the -- the whole process works smoothly.

Today we'll explore some of the issues and the challenges of the proxy voting process. The -- sometimes the problem of overvoting, undervoting, the champ (ph) custody issues, the vote confirmation issues in terms of the shareholders, making sure that their votes were counted and other items that come up as the Chair about the -- Chair had mentioned and Commissioner Stein the issue of universal proxy also, I think, is an issue that they can -- we will ask the panel to address in terms of one of the issues. I agree in terms of it seems crazy in this day and age that you have to actually go to -- physically to a meeting if you want to vote on vote cards or split your votes. I think in this day and age there's got to be a technological solution to this, so I'm very supportive of the Commission moving forward on that.

And then the whole issue of technology, how can we use technology to improve this process. As was mentioned, you know, blockchain digital ledger technology may be an opportunity for us to see as has been used in Estonia and some other markets. What could be done in our -- in our market to facilitate technology to make this process better?

I do think the integrity of our proxy voting system is essential to a -- our good corporate governance program, so we'll ask all the participants and the panelists today to see are they being served well. If not, how could we improve the process? And specifically since we are at the SEC, what recommendations do you have for the Commission in terms of taking actions going forward? As has been said, they will be conducting a roundtable, I think, late this fall sometime on this issue, so I know they're very interested in hearing from the panelist today and in -- and for us participate in -- in that roundtable come late fall.

So without any further ado, let me introduce our first panelist. The Committee has the -- the complete bios of all the individuals, but let me introduce them in the order by which they'll be speaking.

So Ken Bertsch is the executive director of the Council of Institutional Investors, and he's been in that role since 2016. I've known Ken in a variety of the positions that he held prior to this, both at the Society of Corporate Secretaries, CamberView, Morgan Stanley and others.

The second panelist will be David Katz who's a partner at Wachtell Lipton and also an adjunct professor at NYU as we were chatting this morning. David and I have spent a lot of time together over the years during my time at STRS. And he's one of the great -- great corporate lawyers, I would say.



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Third, Brian Schorr who is the -- a partner and chief legal officer at Triumph Fund Management. Also, I had the benefit and the pleasure of working with Brian during my years at CalSTRS as Brian was one of our managers who have spent a lot of time, probably one of the smartest legal minds I know. So welcome, Brian.

Deborah Majoras who is the Chief Legal Officer and Secretary for Procter & Gamble. She's been with the company since 2008. Prior to that, she was here in Washington, D.C. as the Chair of the Federal Trade Commission and has had a long and distinguished career in government as well as in the private sector. So welcome. Nice to have you here.

And then finally, our last panelist on this first session is Arthur Crozier who is the Chairman of Innisfree, a proxy advisor -- proxy solicitation firm, has been involved in, as we'll hear today, in these proxy contest and proxy voting for a number of years, brings a great deal of experience to the debate.

So thank you. Ken, you will kick off the panelists, and welcome and thank you all for participating this morning.

BERTSCH: Okay. Thank you, Chair Sheehan and Members of the IAC, and Chair Clayton and Members of the SEC. So, as Anne said, my name is Ken Bertsch. I represent the Council of Institutional Investors. We have a core membership of asset owners with more than \$4 trillion in assets and asset manager associate members with more than 25 trillion in assets -- assets under management.

So shareholder voting at corporate annual special meetings is a core and essential element of corporate governance, as has already been mentioned this morning. And shareholders have a keen interest in a reliable, transparent and cost-effective system for voting processes -- proxies. CII's asset owner members affirm this in -- in a 2010 statement policy statement that they voted on. And our members currently are considering further elaboration of that policy to urge best use of technology to improve the proxy voting process.

Enhanced policy under consideration suggests it is time to look at distributive ledger technology or -- and it's all sorts of reasons why people say this expression you use is not exactly correct, but I -- I'll -- I would use private blockchains operated by a trusted third party or parties to -- to promote the goals that we have articulated earlier while safeguarding the identities, holdings and vote decisions of individual shareholders.

The current system of proxy voting is fraught with inefficiencies in a too large margin of error. Between the complexity of intermediary chains and challenges around fungible shares, many of our members lack confidence of their shares actually are always voted fully and accurately. Institutional investors generally vote on electric platforms, and I think a lot of our members believe that the -- they should be able to routinely and promptly seek vote confirmations on how their shares are voted in an account on each voting item and the number of shares voted.

Since 2010, market intermediaries have worked on a system to provide vote confirmation on request, but progress has been halting, and the system seems to only work when the stars are truly aligned. That is not most of the time. Vote confirmation has not become routine, efficient or easy. So as -- as Chairman Clayton said there's been significant technological progress since 2010 and we have -- may have more opportunities to build a reliable, transparent and cost-effective proxy voting system not available at that time.

However, systemic change, potentially including distributive ledger technology, would require substantial focus and resources near-term. While the effort would be significant, we do think it's time to seriously explore this as I will discuss. But I do want to note that the universal proxy, Commissioner. Stein mentioned, is -- is very low hanging fruit.

The SEC has well considered 2016 proposal for universal product proxies already has set forth a good path for this. Shareholders usually have no practical ability to vote through proxy voting or voting by proxy to split their ticket and vote for the combination of shareowner and management nominees that they believe best serve their economic interests. Investors frequently have an interest in splitting their tickets, and there is no good reason why

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

they should be required to attend meetings to do so. Shareholder voting by proxy should have the same voting options as a shareholder who votes in person.

Now, Circor International, my organization, has commented extensively on this in -- in letters to the SEC, so I won't not go in further except to address two points that Chairman Clayton has raised with us -- two concerns about the SEC proposal. The first is on the solicitation threshold that would trigger a requirement of universal proxy.

The rule is proposing 2016 would require that a dissident solicit, at least a majority of shares, for the universal proxy rule to kick in. We agreed with that threshold, but in light of the Chairman's concern that this may be too low, we would support moving to a higher threshold that would increase minimum solicitation requirements to 75 percent and require that total number person solicited is -- is more than 10.

I think, Chairman, you -- you talked about more people can fit around the dinner table so that we had some discussion about how many people at dinner table.

(LAUGHTER)

Anyway, the second item is a concern about an incumbent director who would refuse to serve if a dissident is elected with -- with some of the incumbents. And we would suggest that the proposed rule be amended to require a registrant to disclose in its proxy statement if a party's nominee will not serve, if elected, should -- should an opposing party nominee be elected and then how the resulting vacancy would be filled. So we think those two issues can be addressed.

So we think it's time to move ahead with this and we're -- we're glad to address any other issues that come up. We do think the framework that this Commission put forward is very good, so back to the more difficult challenge of -- of more robust proxies of system.

So we think blockchain should be explored. It would -- it would entail construction of the blockchain. An intermediary acting as a gatekeeper would create a blockchain for the company and its shareholders. The blockchain would be private in permission. Neither the company nor other shareholders would be able to see identities or holdings of any individual shareholder. Blockchain would record each of the company's beneficial owners and holdings as of a prerecorded record date and will determine each shareholders' entitlements.

Two, dissemination of proxy materials. The gatekeeper can upload the proxy materials on the blockchain.

Three, vote allocation and authentication. The gatekeeper allocates votes subject to the company's capital structure and voting rights. Shareholders would know precisely how many votes they control before casting them. Before the meeting, whoever executes the votes, the individual shareholder or the designated proxy must authenticate identity with the gatekeeper.

Four, vote execution and tabulation. During the voting period, shareholders or their proxies would execute their instructions over the blockchain. The blockchain would relay the voting instructions and verification that the votes are counted back to each shareholder, ideally providing immediate and accurate end-to-end vote confirmation.

Once the voting period ends, the blockchain can immediately -- immediately report the aggregate results to the company and its shareholders simultaneously. Due to the nature of blockchains, once voter votes are entered, the record of those votes cannot be removed or altered. Now it -- it would -- how you structure this depends on the roles you want to set up, but presumably, you could -- you would set it up so that there could be a revised ballot put through, but all the information would be in the blockchains, so you'd be able to confirm it.

With his approach, we think we could provide timeliness -- enhance timeliness, accessibility, accuracy, certainty and cost-effectiveness. And I want to emphasize, in particular, the end-to-end vote confirmation. That's probably the most important step from the investor standpoint.

So with that, I'll stop and I'm glad to answer questions later.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SHEEHAN: Thank you. Thanks, Ken.

CLAYTON: Can I just jump in and say ...

SHEEHAN: Absolutely.

CLAYTON: ... thanks -- thanks, Ken, for framing those issues that were of concern to me. And to the extent people have comments, I -- I would like to hear them, but, you know, basically, how many people you need to get around the table to decide what the proxy is going to look like, and that ensuring that, you know, if this is what -- what's s being presented that that's s actually the result.

BERTSCH: Right. Yeah, that's s fair concerns.

SHEEHAN: David?

KATZ: Good morning. Thank you, Chairman Clayton, Commissioners, IAC Chairwoman Sheehan, the other Members of the IAC for providing us with the opportunity to participate in today's discussion and address what we do as a very important corporate governance issue that needs to be updated through SEC rulemaking. I also want to thank Alexander Ledbetter and the SEC staff for putting today's program together and for handling all logistics, including dealing with a pesky hurricane named Florence that threatened to disrupt today's meeting.

By way background, I'm a corporate lawyer at Wachtell, Lipton, Rosen & Katz in New York City. I've been practicing for over 30 years. My practice is primarily with -- involving representing public companies and boards of directors. And in recent years, a substantial amount of my time has been devoted to dealing with shareholder activist, contest for corporate control and proxy contest. Thus, I have significant direct experience in navigating the many intricacies of the U.S. proxy voting infrastructure as well as experience with similar structures in Europe and Asia.

Simply put, U.S. voting infrastructure is outdated. Similar to another issue we've addressed with Commission Schedule 13D that came out of the 1968 Williams Act has not kept up with market developments. I promise that that'll be first and last time I mention it today.

The current proxy voting infrastructure was developed for a different era and has not been updated to address fundamental market and technological changes. There are two sets of laws that regulate the ability of shareholders to cast votes in advance of net shareholder meetings for public companies. By and large, led by Delaware, the state law aspects of allowing shareholders to exercise their fundamental rights to the shareholder franchise of kept pace with technological developments and other changes in recent years. Unfortunately, the same cannot be said for the federal law aspects that regulate much of the mechanics of the proxy voting process.

This is the aspect that the SEC regulates both rules and tools that were developed long before emails, faxes, texts and the Internet leaving a glimmer in anyone's eyes. We'll hear from other panelists today, and Ken referred to some of these already about the benefits that technology can bring to the table to address many of the concerns that will be raised today. And it's in my view that we need to embrace much of this technology as we revamp a system that is sorely outdated.

However, these changes must address the interests of both the issuers and investors, including investors who are shareholder activists in a fair and balanced manner that provides a level playing field for all participants. It does not discriminate against any investor, be they institutional or retail. It's essential that we recognize several developments that have occurred in recent years and take them into account as we look to develop a new proxy voting regime for the 21st century.

First, there has been a tremendous concentration in voting power of institutional investors, including passive investment such as index funds. For many public companies, this means that by talking to 20 or 30 investors or, in some cases, fewer than 10, issuers and shareholder activists can talk to the whole different majority or close to majority of the public company shares. This concentration in voting power has significantly lowered the cost of

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

communicating, but this tends to disadvantage issuers who need to communicate with all their shareholders in the context of proxy contest.

Second, and recognizing that the Commission is already examining this issue separately, what we see is the undue influence of proxy advisory firms such as ISS and Glass Lewis to many institutional investors outsource their proxy voting decisions must be taken into account. There has been a recent trend where a number of the major institutional investors have taken their proxy voting decisions back in house not without bearing non-insignificant costs, but most institutional investors, you know, for cost reasons or otherwise have not abandoned the proxy advisory outsourcing model. The proxy advisory firms do not provide equal access to issuers as they do for investors and they are in need of separate regulation, but their impact cannot be neglected as we look to update the current voting -- proxy voting infrastructure.

Third, technology has significantly lowered the cost to communicate with shareholders, especially in situations where shareholder proponents seeks to correspond with the majority of shares or issues generally need to communicate with all shareholders. This can make it significantly more expensive for public company issuers in a proxy contest when facing the shareholder activist. It is in the public interest to make sure that all shareholders, be they large or small, active or passive is in the same information provide to other shareholders, although in practice, this may be easier said than done.

Given there is significant portion of the investments managed by major institutional investors are pension or retirement savings, they're seeking long-term value, we need to develop a system that gives voice to those who were ultimately impacted. The technology can help us achieve that so long as all the impacts of that technology, including unintended consequences are fully considered and taken into account.

Let me address some of the concerns I and many of our clients have with the current proxy voting system and infrastructure. Here, I would note that the interest of issue is in shareholder activists do not always diverge. We'll hear from Brian Schorr of Trian and Debbie Majoras of Procter & Gamble going a number of specific issues that arose in their recent proxy contest. And you'll see that many of these concerns are shared concerns. Professors Ed Rocks and Marcel Kahan's important article discusses many of the problems with the voting system and custodian issues, and also provides some thoughtful suggestions about technology and other developments that can be utilized.

I'd also note that it's in everyone's interest that we develop a system that promotes participation and achieves accuracy in a sufficiently transparent manner, allows individuals and institutions to have their voices appropriately heard in the boardroom and beyond.

Shareholder communications. Simply put, we do not have a system that provides all information -- all shareholders with the same information in a timely manner. It's a routine complaint that many investors, notably not the large institutional investors, receive some of their proxy voting materials after the vote has taken place. This is not just international shareholders who may be subject to the vagaries of the global postal system, but also to the inability of companies communicate directly with their shareholders. They're forced to do so through intermediaries who efforts, unfortunately, often fall short.

Technology should be to overcome many, if not all, of these issues so long as some the roadblocks like the (inaudible) Communications directly with beneficial holders are removed, making sure their votes are counted. There's currently no way for an individual shareholder to make sure that their vote has been accurately and properly cast and counted. This is exacerbated with the practice of share lending since generally institutions will not put shares that had lent out, but this can impact the beneficial owner who has no knowledge of the transaction.

The number of recent contests, institutional shareholders have ended up voting far less than the number of shares they are listed as a holding and so shares has been lent to other parties who would not be able to vote them. This only becomes clear at the end of the process as there is little to no transparency on the lending of shares. Disclosure here could be quite helpful to the process on both sides.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Transfers after the record date. Shares held as of the record date with subsequently transferred often either do not get voted or get voted improperly difficult -- given the difficulty of buying shares and transferring the vote. Similar mechanisms that permit the separation of the vote from underlying economics of the shares that's so-called empty voting need to be regulated. In some cases, this has led to vast overvoting, but the fundamental concern is that when you separate a vote from the underlying economics it tends to favor short-term interest as opposed to those who were focusing on long-term value.

Universal proxy card. As I previously testified in a prior SEC roundtable, universal proxy card does resolve some issues but raises concerns that could favor one party or the other in a proxy contest. I believe those concerns could be addressed. In some circumstances, for example, the universal proxy card could allow shareholders to fully exercise their franchise that they cannot do by voting on a single card if they wish to split their vote.

If you want to split your vote and you can't go to the meeting, there is no mechanism today that allows you to do that and that means many shares do not get voted in those circumstances. This is something that can be changed, but I don't think private ordering will change it because we've had the ability of private order for a long time in one side or the other side or usually both are not willing to agree to some type of universal ballot.

Our current system invites shareholders to vote multiple times as each side sends out numerous mailings and proxy cards. However, there's clearly confusion and maybe shareholders do not understand the last voting cards plants all earlier votes. This system that encourages people to vote early and often is bound to have problems.

The current system leads to significant cost for both sides. Procter & Gamble was most expensive proxy contest on record and has been reported that the ADP Pershing Square proxy contest cost over \$26 million, \$24 million of which was borne by ADP and ultimately the ADP shareholders. When every vote counts, each vote gets expensive. A proxy voting system lacks transparency and is overly complicated. Through the use of technology, we can create a system that provides for the appropriate amount of transparency while ensuring an accurate and timely result.

Thank you for the opportunity to address the -- this important topic. I look forward to our discussion and answering any questions.

SHEEHAN: Thank you. Brian -- yeah, Okay.

CLAYTON: Anne -- Anne, if I can just jump again in real quickly. I have to go to another -- I -- I expect to come back, but I want to thank both of you for framing the issues. And I know the two of you have lived it ...

(LAUGHTER)

... but it's clear there is room for improvement. And there's enough room for improvement where we should do something. Thank you.

SHEEHAN: Thank you. Great. Speaking of the Procter & Gamble fight, so the next two will -- will -- they're experienced in that. Anyway, Brian go ahead.

SCHORR: Thank you. Thank you, Chairman Clayton, Commissioners, Investor Advisory Committee Chairman Sheehan and the other Members of the IAC for providing me an opportunity to participate in today's discussion. Triun Fund Management is an investment management firm. We're founded in 2005. We manage capital for global base of investors that includes institutional investors, individuals, public and private pension plans, and sovereign wealth funds.

As a highly engaged shareowner, Triun principals and partners have gained a total of 14 board seats at 12 different portfolio companies since we were founded in 2005. We have all engaged in three proxy contests in that period of time -- H.J. Heinz in 2006, DuPont in 2015 and Procter & Gamble in 2017. I'd like to focus on these three proxy contest and some of the lessons that we have learned from them.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

First, I would submit to you that shareholders ability to participate in director elections is fundamental to principles of shareholder democracy and the primary mechanism by which shareholders can hold corporate directors accountable. However, in a close proxy contest, the complexities of the current proxy voting infrastructure makes an accurate and verifiable voting tabulation extremely difficult. And keep in mind that an accurate voting tabulation is essential for all shareholder votes, including say-on-pay resolutions and Rule 14A-8 shareholder proposals.

Our 2017 proxy contest with Procter & Gamble shined the spotlight on some of the specific issues and problems with the current proxy voting system. At the outset, let me say that I'm very pleased that Debbie Majoras, Procter & Gamble's Chief Legal Officer and Corporate Secretary who's sitting next me today is joining me on today's panel so that she can share with you the issuer's perspective. Let me put some of it in perspective.

In the P&G proxy contest where approximately two million votes were cast, the final certified results showed a voting margin of approximately one-quarter of one percent. As David just said, virtually, every vote cast have the potential to be the deciding vote.

This was likely the closest proxy contest to date. Both sides examined over 100,000 proxy cards during a two and a half week review period after the preliminary certified results came out would show that Trian's Nelson Peltz was ahead by approximately 43,000 votes out of that, remember, \$2 billion. Trian and P&G ultimately settled with Mr. Peltz joining the P&G board in early March of 2018.

In broad strokes, let me summarize some of the problems that we found from the simple to the very complex. Let me start with overvoting. Overvoting can happen, for example, when securities intermediaries, brokers, custodians will hold the shares when the shares which they sometimes do for a fee. Only shares that are held on the record date can be voted so that the shares that are loaned out cannot be voted.

If voting instructions are received for more shares than held on the record date and there's no cutback in the number of votes submitted, an overvote occurs. What we found was that certain overvoting by securities intermediaries was not reconciled by the inspector of election until after the announcement of a certified tabulation of vote by the independent inspector. So think about it. Certified vote was announced in preliminary basis, and yet full reconciliation had not been done.

Second, let me talk about chain of custody. There's generally no way for beneficial owner to confirm that its shares were actually voted. In addition, a break in the voting chain of authority between a voting intermediary like Broadridge, the custodian, and subcustodians and the company's registered list has the potential to result in shares not being included in the tabulation. As a result, there's no consistent end-to-end voting confirmation. And let me share with you two examples where break in the chain of custody resulted in shares not being counted.

We found one major financial institution, which learned that because of chain of custody issues the voting process that had been using for nearly a decade to vote a portfolio of shares held in one account resulted in that portfolio of shares being excluded by the independent inspector from the tabulation of every contested proxy contest during that tenure period. We found a situation where shares were voted by a small fund administrator were excluded because the name of the Broadridge client was changed following the transfer of the fund administration business even though the custodian remained unchanged and the ultimate beneficial owners had not been any -- had not made any changes to how they held or voted the shares.

And then there's just a simple issue of what happens when you vote a paper ballot. Think about the lack of a paperclip. One retail shareholder at the annual meeting tried to voting shares at the annual meeting by submitting a legal proxy and a ballot. And those shares were not initially tabulated because the legal proxy and ballot was separated from each other between the time of the annual meeting and the tabulation by the independent inspector. That separation occurred for want of a paperclip. Ultimately, those shares were counted.

Another area of focus might be empty voting in the context of Employee Stock Ownership Plans. Should shares held in a company ESOP for future participants and which are therefore unallocated to current participants, employees and retirees be voted on a mirror percentage to match the shares that were allocated to and voted by

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

current plan participants who tend to vote for management, I would suggest to you that that does not produce a fair and equitable result.

I would also point out that the universal proxy card might have some utility here. In corporate elections, as has been said before, shareholders can vote multiple times. In the P&G proxy contest, Trian and Procter & Gamble, they're more than a dozen mailings between them. So shareholders had many, many proxy cards to choose from and many, many opportunities to change the vote and submit later data proxy cards or even change the vote if they appeared in person at the annual meeting. This sometimes leads the questions of which card was the last voted proxy card since that is the card, which is ultimately counted.

In January 2017, Trian submitted transmitted a comment letter to the SEC in support of the SEC's universal proxy card proposal. We believe that not only does the use of a universal proxy card support good corporate governance by providing all shareholders that vote by proxy whether you're a main street investor or institutional shareholder with the same choices available to shareholders who attended annual meeting. But in addition, it could also play a role in simplifying the proxy voting process and reducing tabulation issues by helping to eliminate the problem of identifying the last voted proxy card and if invalid conflicting proxy cards that arise when a shareholder tries to mix and match nominees for competing slates.

The current proxy system is overly complicated making end-to-end voting confirmation to something that is not readily available today. In addition, the current system makes it accurate, verifiable vote tabulation extremely difficult in a close election. Furthermore the voting process seems more onerous and costly than necessary and should be updated adequately and efficiently meet the needs of the shareholders and issuers. But regardless of the voting margin, shareholder votes must be accurately tabulated to ensure the integrity of the shareholder voting process.

Thank you for the opportunity to share these thoughts. I look forward to the dialogue.

SHEEHAN: Thank you, Brian.

Debbie, welcome. Nice to have you here.

MAJORAS: Oh, thank you so much to the Committee for asking me to participate, also to Chairman Clayton and the ...

SHEEHAN: Nice to have you here.

MAJORAS: Well, thank you so much to the Committee for asking me to participate, also to Chairman Clayton and the Commissioners and staff here at the SEC, and to my fellow participants for sharing their thoughts, including Brian Schorr.

I think we all agree that for shareholders to effectively exercise their right to vote on certain corporate matters, we need a process that ensures simplicity, transparency and accuracy and were here because most of us agree that we're falling short. In most years and in most elections, when directors are elected with 90 plus percent of the vote, systemic deficiencies don't necessarily surface, but in a close election the issues come into sharper focus and remind us that it's time to reevaluate, update and improve.

In its 180-year history, P&G, like most companies, have never faced a proxy contest until last summer. And sometimes it takes a unique or least unusual situation to highlight complexities and problems and here was our situation. P&G has more than \$2.5 billion outstanding shares, which are held by about three million shareholders. Of those, about 40 percent are retail shareholders, double the size of most companies.

This retail community includes employees and retirees who hold about 10 to 15 percent of our shares through stock plans and personal accounts. We also have a sizable number of international shareholders with about 14 percent of our shares being held by shareholders outside the U.S. It is also notable that about half of our three million shareholders hold less than 100 shares.

## SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

Of course, the majority of our shares are still held by institutional investors and while we're concerned about those proxy voting issues, I thought today I would focus on the retail shareholder. Communication with shareholders is essential to their making informed choices and yet it's challenging. In a typical year, we mail fewer than 200,000 hard copies of our full proxy materials. For the rest we use either notice and access or electronic delivery. About 800,000 of our shareholders receive their materials electronically.

But in a contested election, Broadridge does not permit either side to distribute materials electronically. So consequently, whenever we wanted to communicate with this large shareholder base we had to mail them hard copies even when they didn't want them.

Proxy materials mailed internationally could take weeks to arrive. I know David alluded to that, which means that they may arrive after the meeting is over. So in a world where people's lives are literally run through their mobile devices, companies really have to have a user-friendly electronic way to connect with shareholders and invite engagement, especially in a proxy contest.

Communication is hindered and has been mentioned because the SEC's ONO/NOBO will also prevent companies from having access to the names of our -- most of our investors. Shareholders on the OBO list hold more than 60 percent of P&G's outstanding shares and yet we have no way to communicate with them directly. The required paper mailings are filtered through their brokers with no real way for issuers to confirm whether those mailings were handled properly. And while we very much support consumer privacy and it must be respected, we do think the structure of those rules should also be reviewed.

Of course, there is the fundamental challenge of engaging retail shareholders who may not understand the importance of voting. With retail turnout typically around 25 percent, we should examine whether we can do more to convince them that their votes matter. The experts say that the way to increase retail turnout is to make multiple context, which Brian said during the proxy contest needs multiple paper mailings.

In that contest, many retail shareholders received over a dozen hardcopy packets of information collectively, but some had multiple accounts, so then that was multiplied by the number of accounts. It did increase our -- our retail vote participation to 50 percent, but it also not surprisingly led to frustration and complaints. Many were confused, others found it environmentally unfriendly, and many were just plain annoyed like why do I have all this paper. If they want retail shareholders to vote, then we have to give them a convenient and user-friendly method by which to do it.

Online voting works fairly well, but only if the shareholder has the control number to login. While control numbers are included in the mailing, shareholders often misplace or accidentally discard them and then replacing them is not easy. So for beneficial owners, Broadridge generates and keeps these numbers and is typically unwilling to -- to provide the replacement control numbers by email or phone. Rather, the beneficial owner has to go back to the DTCC participant, which then contacts the voting intermediary, which then mails the number to the beneficial and another hardcopy.

Requiring a separate control number rather than perhaps utilizing an existing personal data is so cumbersome that we know that many shareholders just simply give up. And for a shareholder outside the U.S. waiting for your control number, we had frequent -- we had frequent issues with that and some are just simply deprived of their voting rights because they never got it. Again, in an age when consumers are used to doing everything online from banking to buying a car, we have to find an efficient yet secure way for shareholders to vote their shares.

For those who vote by proxy card, Brian and others mentioned there's just -- the card has multiple opportunities to be disqualified, particularly when names or titles are slight or slightly mismatched, and we have lots of examples of that for another time. For beneficial owners, it's even uncertain whether their votes will actually be executed because those votes have to be filtered, as you know, through brokers or other custodians and there's lots of room for air there as well.



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Overvoting and undervoting are common. For example, a shareholder typically does not know, as -- as Brian said, if a broker has loaned out their shares. And finally, for the shareholders' will to be executed, as we've all said here, and it seems so obvious we have to have an accurate vote count, yet voting inspectors are still relying on highly manual processes especially when the vote is close. I'm sorry, precision is critical especially when the vote is close, but the voting inspectors are still relying on very manual processes where they have to make a number of subjective judgments. For example, figuring out which is the card that actually count and with tens of thousands of cards to be sorted and tabulated, there's just no question that there are going to be errors. We know from experience, groups of ballots get rubberbanded together and they don't all get counted. Some ballots stuck together and they didn't -- they -- they didn't all get counted.

And then finally, I would say early in this tabulation process, the inspector is required to issue a preliminary report, which is, by definition, preliminary so it's going to have errors. In a contest as close as ours, while we definitely believe that shareholders have the right to information, they ought to have accurate information. And when that -- that number is what a -- a tabulation was put out there into the media, most shareholders did not understand that it was a preliminary number, and it caused a lot of confusion. So I think that's something else to look at.

So, we do think at P&G it's time to consider proxy plumbing reform involved. We hope to not go through that experience again. I will tell you that -- that we did and we are -- we are ready to help in any way we can. Thank you very much.

SHEEHAN: Thank you. Arthur?

CROZIER: Thank you, Chairman Clayton, Commissioners, Chairman Sheehan and the other Members of the Investment -- Investor Advisory Committee for the invitation to speak today. I am the Chairman of Innisfree M&A Incorporated, a proxy solicitation firm that specializes in proxy fights and other contentious solicitations. I've been involved in proxy solicitation since the mid-1980's and I have the scars to prove it.

There'll be a lot of discussion today regarding the use of technology to resolve serious -- very serious issues in the proxy voting process. Technology solutions, which do offer the potential for great improvement in the current proxy voting process, however, are likely a long time incoming and will undoubtedly create other issues that will also have to be resolved.

I will confine my remarks today to three issues that could be addressed in a comparatively short period. One, increasing voting participation by individual holders, reducing to a minimum the brakes in the custodial chain of voting authority resulting in otherwise valid votes not being counted, and universal proxy cards.

The problem of voting by individual investors, while the percentage of individual holders as participants in the equity capital markets has declined precipitously over the last several decades, those holders can and should still play an important role in the electoral process of publicly-traded companies. Many proxy contests, in particular, are decided by extremely small margins, not just Procter & Gamble. Individual support can also be crucial for proposals that require a supermajority vote or transactions that have a majority of the minority vote requirement.

According to Broadridge and PwC, however, participation by individual holders declined in the second half of last year to only 27 percent, down from 28 percent the prior year notwithstanding the recent efforts to use the Internet and email to make voting easier through changes such as notice and access and email delivery of proxy materials and voting instructions. In fact, our experience -- in our experience, those changes have actually resulted in lower participation by retail holders.

The problem is ultimately neither a technology problem nor a problem that can be resolved through technology alone. The problem is ultimately a behavioral one. Individual holders lead very busy lives and voting in corporate elections is not a major priority. In our experience, the best way to increase participation by individual holders is through regular contact during the solicitation period, by hardcopy mailings with proxy cards and by direct solicitation through telephone calls in which our solicitors can take votes during the call. While such regular contact

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

can be seen as annoying by some holders, potentially confusion, it is, in fact, very effective and produces -- can increase participation to 50 percent or even possibly more.

At this time, however, the only way for issuers to reach out directly to individual holders is if they are non-objecting beneficial owners, so-called NOBOs, or as we usually describe them the people who forgot to check a box when they opened up their brokerage account. In our experience, NOBOs usually constitute most 50 percent of the shares held by individual holders to the company. Modifying the current rules to facilitate more individuals becoming NOBOs could increase voter participation, establishing a process whereby companies could solicit proxy votes directly from individual holders rather than through broker intermediaries could also substantially increase participation. For example, a broker could give the issuer a written authorization or omnibus proxy authorizing their clients to vote directly with the issuer.

The other -- the second concern I'd like to talk about is reducing the brakes in the custodial chain of voting authority, as Brian had just discussed. And that was a significant problem at Procter & Gamble as well as the other proxy fights. And it results in the invalidation of otherwise valid votes due to breaks in the custodial chain.

The determination of the person or entity entitled to vote shares is determined by state law. In order to vote, the holder must be on there issuers registered list or have written authority from a registered holder to vote in its stead. Since most shares are held in the Street in the names of custodians, almost all Street shares are held on the registered list by a nominee, CD & Co., which in turn designates through an omnibus proxy the number of shares that each custodian can vote.

But once CD & Co. issues the omnibus proxy, its responsibilities and actions with respect to voting at the meeting come to an end. The custodians must then transmit to Broadridge and the other voting intermediaries the relevant information for their clients holding shares on the record date in order for the intermediaries to distribute proxy materials to those holders, receive voting instructions from those holders and then vote in accordance with those instructions in the names of the custodians.

That all sounds straightforward, sort of. The problem is that the information supplied by the custodians and the information maintained by the voting intermediaries often do not match the information on CD's omnibus proxy, which is the final word on entitlement to vote. A custodian may report to the intermediary that shares are held in the name of an affiliate, but that affiliate's name is not on CD's omnibus proxy or the custodian may be clearing for a variety of smaller regional sub-custodians, which vote on behalf of their customers, but the necessary paperwork, so-called respondent proxies authorizing the sub-custodians to vote have not been issued.

In those cases, again votes that have been cast by shareholders fully entitled to vote may not be counted and those shareholders are disenfranchised. It is important that the custodians and voting intermediaries regularly review their processes and records to ensure that the information used to disseminate proxy materials and to process voting instructions conforms the information that custodians apply to DTCC for purposes of the omnibus proxy. It is particularly important that where subcustodians have the authority to vote that respondent proxies are issued reflecting that authority.

These breaks in custodial chain are usually not one-offs but are our recurring problems as I think Brian mentioned in the one case in the Procter & Gamble fight. You know, clear out the records, make sure it conforms into it on a regular basis. It shouldn't be hard.

The third topic is universal proxy cards, and I know I am not exactly a voice crying in the wilderness on this. We believes that universal proxy cards are appropriate. Under the current system, you can have distorted voting results that do not reflect the true desires of the shareholders in terms of composition and shareholder base since shareholders are prevented from voting for all seats up for election.

And by voting on only one card and possibly withholding on a certain number of directors, if someone wants to only elect two dissident nominees, their only choice is to vote for those two dissident nominees on the dissident court and withhold on the other nominees, thereby not testing any votes for the other open seats, which results in the

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

distortion of what the shareholders want to the extent that there are other shareholders who were bullet voting. Even though they don't represent a majority of the shares voted, they're bullet voting for additional candidates on the dissident court. For example, it can also work the other way for the management court. As everybody has mentioned, the only way for -- to vote for candidates on both slates is to go to the expense and inconvenience of attending a meeting and voting in person or authorizing the other person to do so.

There has long been a concern that universal proxies would favor the dissident and that was a reason for not doing it. Our experience, however, which has been borne out by a few academic papers is that a universal proxy card would generally favor management, if only because the likelihood that the proxy advisory firms would support some of the dissidents' nominees and under the current rules, none of the management's nominees, thereby resulting in an artificial vote for a limited number of directors and not for a full slate.

We use the universal proxy card and the proxy contest to Transocean several years ago. Transocean is listed on the New York Stock Exchange, but it's incorporated in Switzerland, which requires that all nominees must appear on the company's card.

We, in the dissident, use identical proxy cards that included both slates and experienced few difficulties in voting. But there is one issue I think, in particular, that we -- that needs to be addressed from universal proxy card in -- in our view and our experience, and it comes back again to voting by retail holders.

By permitting a holder to pick nominees from both sides, there is a possibility that he or she will vote for more nominees than the number of open seats. In that case, the shareholders vote must be excluded, disenfranchising the shareholder since there is no way to determine the voter's intent with respect to the seats that are actually open.

This is not a problem for institutions or individual holders that vote on an electronic platform since safeguards against the drive overvoting can easily be programmed. The real concern are individual holders voting on print -- paper proxy card. Card design to minimize over votes is essential, particularly for voting intermediaries, which are fairly inflexible voting instruction forms. And because the penalty for inadvertently overvoting is so severe disenfranchisement, there should be also in place a process whereby the voting intermediaries must inform any holders that have overvoted and give them an opportunity to correct their votes.

Again, while we believe the technology can help solve many of the current proxy voting issues and that the Commission should stay focused on facilitating those solutions, they are unlikely to be in place soon. And so it is important to focus on less complex, faster to implement solutions. There are many other issues such as voting issues caused by share lending that can also be addressed in the same way, but time does not permit a full discussion at this one.

Thank you again for the opportunity to -- to participate in this important process, and I look forward to today's discussion.

SHEEHAN: Thank you all. So questions from the Committee members, first I'm going to call on the Committee members who are here in the room. And then for the folks on the phone, if you have an interest in asking a question, I'll -- we'll -- I'll go to the phone members after we conclude the questions from the folks present.

So, I think J.W., and then Heidi, and then Damon, and then Lisa.

VERRET: Yeah. First, to just a point of background and then a question about three ideas that we haven't heard about yet. So, first, you know, a reminder of the lesson of history that the last time the SEC engaged in a mutual rulemaking on proxy issues it was struck down by the D.C. circuit and business roundtable versus SEC. And part of the reasoning in the referenced state law and -- and preemption of state law.

A lot of the arguments about issues in -- in this space involve an analogy to democracy -- to social democracy. And I would offer that that analogy is incredibly strained and that suggested benefits of proxy reform that would bring us

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

closer to an idealized social democracy in which votes are perfect and more clean and such or somewhat irrelevant for the purposes of the economic analysis mandate put onto the Commission. In fact, I think that -- that corporate voting under a contractual relationship has about as much to do with social democracy as it has to do with tennis or fishing, which is to say not very much at all. And I think that business roundtable vs. SEC in a number of other cases suggests that the internal affairs doctrine should be read in conjunction with the economic analysis mandate that is placed on the SEC.

Three ideas, I'm interested in your pushback or thoughts on that. And also just three ideas I'll throw out really quickly that the SEC should consider that I think would put an approach to proxy -- proxy reform more in line with what I just suggested. First, the SEC has the power to certify questions of state law to the state Supreme Court of Delaware. That's s not true with all states, but I think more states would do it, would -- would permit it if the SEC use that certification mechanism more frequently. It hasn't done so since AFSCME versus CA, but I think certification of state law questions that arise in, for example, the no-action process for shareholder proposals would be more helpful. And I think a process to affirmatively require it is something the SEC could consider now.

Secondly, during proxy, reform in -- in -- in 2010, 2011, I know Professor Coates and I debated the opt-in versus opt-out. I think we haven't heard about opt-in yet rather than mandatory systems, but I think opt-in should be a part of the discussion.

And then thirdly, I talked to a lot of investment advisors and I asked them, do you have -- do you feel that you could adopt a -- a voting system in which you defer to management in the absence of red flags? And they say, no, we don't feel like we could. And I talked to SEC folks who say that's s not prohibited. There's s a disconnect there and I think guidance would be helpful. So those are three ideas I'd offer for your consideration coming.

SHEEHAN: So, panelists, who would like to address any of the questions that -- David?

KATZ: Thank you, Professor. I -- there -- there are good points and obviously business roundtable versus SEC has to be taken into account any of this. And I -- I do think that there is a distinction between the mechanisms that need to be used and the state law considerations. There will be times where the SEC may need to certify an issue. I think the Delaware process works well when it's s been used, and there would be no reason not to use it in appropriate situations.

I think most of the proxy situations though don't entail now. On shareholder proposals, that could be an area where the staff obviously gets competing legal opinions. That may be an area where they would want somebody to weigh in.

As far as the -- the -- the opt-in, opt-out, you know, it's s certainly something that can be considered. I -- you know, I think you could debate both sides of that issue as you -- you two have in the past, but the -- the -- the third one on - - on -- you know, providing guidance generally, you know, I -- I think -- I think that there is a -- there -- there are ways to fashion something that works here.

My big concern though is that, you know, the system is so broken that it's s not a question of trying to have an idealized social democracy intake, it's s trying to get an accurate vote without giving one side or the other a -- a real advantage. And the mechanisms that deny certain groups of shareholders, like retail shareholders and others, the ability to really have a role at the table, I think, that's s -- that's in problematic.

SHEEHAN: Any of the other panelists want to address any of the issues that you had?

BERTSCH: Yeah, maybe I'll just second ...

SHEEHAN: Okay.

BERTSCH: ... David's s comments. I -- I think for our members it's s really -- on this issue it's s not trying to analogize to social democracy, it's s just there is this process and they -- they perceive that s broken sometimes and they're not confident that their votes are cast the way that they intended or the number of shares are cast. And so when you

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

have overvoting because somebody else was lending shares, but it's your broker and you are arbitrarily cut in your voting power with having nothing to do with you, that's just a -- that's a process issue and -- and I -- I don't think it is over -- overdoing the democracy element to say that that disrupts the process. We do look to corporate elections just to answer some of these things.

SHEEHAN: Heidi?

STAM: Yes. Thank you, thank you for your very informative presentation. I appreciate it. I feel a lot of consensus among all of you about the need for improvement in this area, but it's a big systemic lead. And so my question, I think, investors depend on progress in this area, it's vitally important. Are there things that the Commission can think about doing which would not require the time and energy of a huge systemic overhaul, which I think we should work towards but we need to acknowledge it's going to take a long time? Is -- are there things that can be done relatively quickly that would make the process better for investors and -- and also better for issuers?

And if there's -- I heard about the universal proxy and obviously, that's been a very important step forward. I hear a lot of support for that with minor tweaks. Anything in addition to that that anybody would suggest that the Commission could focus on?

SHEEHAN: David?

KATZ: I mean, I -- I think promoting -- promoting the use of technology you have some private ordering that's going on now where you have some competing systems that are coming out. I think that the SEC has to decide right now it's -- it's a virtual monopoly that -- that's in the -- in the middle there and, you know, whether competition would be helpful or whether the -- you know, you could have different providers providing the same service, but using different types of technology that -- that companies and issuers and -- could -- could use and can work together. There should be a common solution with that.

I think the difficulty has been that the SEC has tried to step back because it's been very concerned about interfering here. And the problem is the technology is just overtaken where we are. And I think, you know, from discussions with -- with Chairman Clayton and -- and others at the Commission, it seems that, you know, there's a recognition that we can't continue to -- you know, if there's technological solutions here, we have to try to embrace them as opposed to push them off.

SHEEHAN: Deborah?

MAJORAS: One -- one of the things I would say about the -- the technology piece Heidi and -- I always get a little bit nervous when I start down an avenue like this where lots of people, including some sitting behind me know a lot more about this than I do. But when we talk about technological solutions here, it can sound like what you said before, which is there's got to be, you know, really this very large multiyear effort. And some of that may be true, and so we got to get started on it, but you're asking for some of the more low hanging fruit.

And I -- and I would say, you know, I'm very interested in some of these blockchain proposals and others don't how quickly that could all be implemented. But we do have what will spice up be considered low-level technology today, right? Things like -- things like email notifications and -- and online ways of communicating, which again that's how everyone communicates in the world. And so while there are security issues, it's hard to imagine that those are worse than the security issues in -- you know, when you're communicating with your bank or your doctor. That seems to me that trying to look for some of those solutions even, as we said communicating with retail shareholders, the Commission has said through Chairman Clayton -- Chairman Sheehan has said we really have to think about the retail shareholder and how we engage them further.

And so one of the things that we saw is that retail shareholders are screaming, "I don't want to communicate with you. This way, I can tell you that. And so if we know that they'd like to communicate with us to the extent they want to communicate with us at all in ways that they're used to in their daily lives, can we explore some of that and try to

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

make that a little bit easier? It just seems to me that -- that that's at least a -- a short-term, if not intermediate step that -- that we ought to explore.

STAM: Yeah, that -- that sounds, you know, very appropriate. And if there's anything that the Commission can do to help facilitate that, I think, you know, it would be an investor's best interest to support. Thank you.

SHEEHAN: Any -- would you -- I know Ken wants to address this.

(UNKNOWN): That's right.

SCHORR: Anne, I ...

SHEEHAN: So Brian and Ken want to address this, Okay.

SCHORR: ... I would just echo one point that -- that remain and then that one other one of that is I -- I do agree that there needs to be a focus on -- on the retail. You know, there was some allusion to the fact that in a contested proxy contest you have to send out the hard copy proxy statements. And -- you know, and as was said, I mean, it's -- it's a real problem that that, in this day and age, is the only way you can communicate, right, whether it's sending six copies or 12 copies of proxy statements. And if you have multiple accounts, if you have an account in your son's name and your daughter's name, and you have one in -- an IRA and another one in 401(k), all of a sudden instead of getting six, you get 24 copies of the materials. I mean, it's -- it's just -- you know, when you -- when you get home each day and you see it on your doorstep, it's -- it's not something you look forward to do. That's number one.

Number two, you know, one of the issues that we touched upon was the whole question of reconciliation overvoting, undervoting. David mentioned transparency. I mentioned the fact that there was no reconciliation done before there was a -- you know, the -- the preliminary certified results, there's no requirement for that reconciliation to be done. So, there's -- there must be some way that, you know, before results -- before certified results, whether they be preliminary or final, you know, are -- are put out that the overvoting/undervoting voting reconciliation is completed. I mean, it -- it's just -- it makes no sense to have a called certified result come out.

And putting aside the -- any review, any challenges, any mistakes that are found, but the fact that the part of the process doesn't include the -- the reconciliation that you know has to take place. So I -- I think that's -- that's a very simple thing that can be taken care of.

SHEEHAN: Okay. Ken?

BERTSCH: Yeah, I would just comment. I appreciate your comments and Art Crozier similarly suggested and as did Brian, just now there are some steps. But I do think we should spend some time thinking about what the bigger long-term solution to this may be that the whole system is so archaic.

And I think we do now see the outlines of vastly different technological solutions that could be much better. So I -- I -- I think it's -- and I know this issue is never the most important issue, but it's -- there's always something else that's more important.

STAM: No, we'll never catch up if we don't start working on it now.

BERTSCH: Right, exactly. So I think we should think about the big solutions.

STAM: Absolutely. Thank you.

SHEEHAN: So, Damon, before I recognize you, I know Commissioner Stein had a question.

And then, Commissioner Roisman, I'll see if you have any questions at this point.

STEIN: Well, I actually -- I have two comments. One is Chairman Clayton asked me before he left if someone on the panel could define naked voting so people could understand what that was. And then on my own part, I

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

thought it'll be great to go through the panel and say what's the low hanging fruit that you think the Commission should focus on in the next six months, right? The next year, what would you recommend?

SHEEHAN: So, why don't we just go right down the -- the panel. So, Arthur, we'll start with you if -- well, do -- who wants to address the naked voting issue?

CROZIER: I mean, I'll ...

SHEEHAN: Arthur?

CROZIER: ... I'll start. You know, naked voting is essentially a process whereby someone holds shares on the record date and is entitled to vote at the meeting. But whether it's through some sort of derivative positions or otherwise, they actually have no economic interest in the company. And so they are casting a vote without having the underlying economic interest because perhaps their -- if, you know, there are holders on another side or whatever that they are trying to manipulate a vote on that side to benefit another position that they hold.

I think in terms of the things to be done quickly or perhaps not so quickly, again as I mentioned in my remarks, looking into NOBO situation to -- to -- to -- to rethink that process to encourage more people to become NOBOs and -- and also see if there's ways as we suggested to permit issuers to contact those NOBOs directly and take their votes directly.

One of the other issues that people have commented on a couple of different times is the problem of overvoting/undervoting, a lot of which is attributable to share lending, which is never going to go away. But understand that the problem of share -- that the voting problems caused by lending shares is largely in the hands of the institutional investors themselves, the folks who are were lending out their shares.

And a lot of times, I think, their concern is they don't -- they need to do it for economic purposes and while they would like to be able to call back the shares into their account on the record date in order to be able to vote them because if they're not actually in their account in a long position on the record date, they can't vote. They don't know when the record date is. And if there was a process that companies needed to push out the record date in a more public way, insufficient time for investors to make the choice whether they want to pull back the shares, call back the shares to be able to vote them or leave them out on one.

MAJORAS: Thank you. I won't repeat anything that's been said here. Either one of mine was this issue around being able to use electronic delivery email systems and so forth, which I think is one.

Two, I think if the Commission could look at the rule that requires a preliminary vote to be certified in -- in an 8-K to be filed because again that -- maybe it wouldn't always be the case, but just fomented more drama and -- and confusion, I think, among shareholders than was needed and -- and certainly wasn't very helpful. So that would be -- that would be number two.

And then three, this is a -- this is a little bit more process for how we get there, but I really do think getting all of the representatives in one room so that people can see all of the intermediaries that things go through and -- and what rules each of them have created, some of which are required by state law or SEC rules, some of which, you know, they have required because of their experience which is -- which is very valid. But on the other hand, all this stuff stacks up to the point where I remember one point during the proxy contest saying, can I put on here so that the voter will understand? Can I put these words just -- you know, and the answer is no. You're not allowed to do that. You can't put anything there to -- you know.

And so -- so I think -- I think there are smaller things that we can look at. And -- but I think it requires really truly looking at this from an end-to-end perspective and reminding ourselves what's really required under the law, which one of the things the professor mentioned and -- and what -- what are we just doing out of practice or habit that we really could change. So that's more process than an individual thing but ...

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SCHORR: As I mentioned before I think again transparency and -- and dealing with the overvoting/undervoting reconciliation and -- and being able to reach out to retail shareholders in a way other than just sending the paper -- paper proxies.

KATZ: I don't think there's a need to echo a lot of comments they have made, but I think that by exploring the blockchain technology used not just here but I think there are other opportunities that the staff is already looking at in trading and -- and other enforcement mechanisms and other things, I think that the same technology can easily be transported into this area, and it's not -- would not be reinventing the wheel.

I think the biggest issue is going to be are we going to, you know, have a single provider, are we going to allow multiple providers and what's the benefit and detriment of doing that.

BERTSCH: And obviously I mentioned universal proxy already. I do like Art's idea, which I haven't really heard before of much better earlier notification of record dates at one of the asset managers I worked for. This was a -- a very difficult issue to wrestle with. When did we want to recall ...

(UNKNOWN): Yeah.

BERTSCH: ... shares with -- with the early record date system prevalent in the U.S.? It's -- it's just -- it's very hard to know. But we did not know we had companies that are portfolio management team or teams had very serious concerns about. And so just an early record date system so we could know much more clearly what we had to do by one would be helpful.

CROZIER: I would just comment -- I would just comment that the Commission's rules right now and particularly for an annual meeting require the issuer to publicly note as a record date 20 business days in advance of the meeting date -- a month for all intents and purposes. But that notice goes only to the voting intermediaries, Broadridge and the others, and it's not really a matter of public dissemination.

SHEEHAN: Yeah. And the -- the issue of calling back shares, I personally went through that at CalSTRS because we did lend our shares, and we wouldn't -- you would want to call them back to vote them. But because of the record date, during the BofA-Merrill Lynch thing you missed it. And, you know, there were huge consequences on -- you know, have -- 10 years ago for those of us who remember that, and it was really problematic in terms of that. So we actually became overly conservative in pulling things back looking at last year's and just kind of making a guess, but it made it very difficult because it -- it was foregone revenue in terms of that.

So, anything -- all right, Damon?

SILVERS: All right. Well, like, I think, everyone else, I -- I found this very helpful and I appreciate everyone -- everyone coming. There is, I think, shall we say that some of these conversations have been going on a long time. And I just want to make sure that sort of -- I think maybe in the spirit of our -- of the -- Chairman Clayton's question about -- about naked voting that we just get a few things on the table, make sure everybody agrees that these things are so.

Several people talked -- several of you talked about the problem of getting individual investors to a vote. And I think there's a lot of confusion about who -- about how individual investors sort of interface with the proxy voting system. Obviously, it's people who are actually on the share register, often employees are on the share and retirees are on the share register, you had -- and then you have individuals who invest through brokerage accounts who turn up in the -- in the -- the beneficial owner -- the various beneficial owner list.

And then you have people who are investing actually through large institutions, sometimes referred to as individual investors. But if -- the way I individually invest is -- is through a Vanguard or a Fidelity Mutual Fund, I don't have any voting rights, right? And actually Fidelity or Vanguard is voting.



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

With all that in mind, everybody agrees, right, that -- that -- that there was a collapse in -- in the participation of individual investors who had individual voting rights following the decision to allow companies to communicate with them exclusively by web, by the Internet, right? That as a factual matter, nobody disagrees with that, right?

Okay. Because it seems to me, A, that which -- what this panel has been talking about if we want to get individual investors to participate we got to -- we've got to reckon with that fact. And that -- that if you're -- if you're concerned about that, perhaps that decision was a mistake. So nobody disagrees with that.

Secondly, I think it's already been established that there's kind of a consensus that there's some way to do universal proxy that -- that maybe everybody could live with. I -- I think we kind of -- I think we kind of get that on the table. Is that right? Well, sort of. There was some way, right? I don't want to get into all the details of each person's particular views, but there is some way to do that because I think if we've established that then to Heidi's point, we've established some path of -- of -- of improvement. I don't know. Maybe -- maybe some of us wouldn't agree, but -- based on JW's comments, but at least the panel agrees.

And -- and I want to establish a third thing that everybody agrees on or it's going to come up later today, but I think it's critical in terms of this panel, which is there have been several panelists talking about the need to try to orient the system toward long-term investors. And I just want to make sure people agree that, in fact, the long -- where the big money is in long-term investors is in index mutual funds and -- and indexed -- large indexed DB plans like CalSTRS and CalPERS and so forth. When you're talking about long-term investors, that's who you're talking about as a -- as a -- just as a factual matter.

Now, what I'm really concerned about and I want to -- and I have a specific question to David about this because, David, I know you and your colleagues at Wachtell and the person whom your -- and the person whom your Chair is named after, my friend Marty Lipton, have thought about this a lot, which is this, this conversation has presumed that the problem that the -- that the fundamental tension in our corporate governance system is the tension between investors and managers. And I know that that's how people often experience it, the good people in the business of proxy solicitations.

My concern is that, in fact, what I'm worried about is the collusion between investors and managers, meaning that we have a ton of evidence that our corporate governance system, our capital market system is encouraging short-termism. The most dramatic piece of evidence we have is the fact that an enormous amount of money was just handed over to our public companies from the public fisc in the Republican tax bill, \$1 trillion of which -- with the explicit purpose, as President Trump said, have encouraging investment, and \$1 trillion of it was handed out in -- in dividends and in stock buybacks.

And that involved the -- in -- in my view, cooperation between short-term interests in the capital markets and management. And so with that in mind -- and, David, what in your view would transfer -- is what steps, in your view, in the proxy system -- and I want to confine myself to proxy process -- to the -- to the proxy -- proxy process, the -- the infrastructure we were talking about just now. But what steps, in your view, would most effectively actually empower long-term investors and get them to behave like long-term investors?

KATZ: I think it would require significant change in the system, but I think that there are abilities to change. I mean, one of the things obviously is the whole focus on short-term reporting, quarterly reporting. Now, you know, quarterly reporting, many investors will say increases accountability, but by the same token, if you are reporting quarterly results you tend to be focused on those and be making decisions that impact those directly.

I think if you're looking at the proxy process specifically, you know, while it would not be a universally held view by any stretch of the imagination, I think that you would find that companies that have staggered the words even though they have gone out of -- out of vote so to speak, you know, are more focused on the long-term because they don't have the same short-term pressures than an activist can necessarily bring in those types of stipulations.

Beyond that, I -- I don't think that there is collusion. I think that there is enormous pressure that shareholders can bring to bear, especially activist shareholders but other shoulders as well. I think that there are oftentimes where

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

companies are caught in between making investment decisions or dividend or doing stock buybacks. Part of that is, in fact, because of the benefits to individuals when they -- when they can cash out in that manner. Part of it is that tax laws, as they exist, don't necessarily promote that investment the way they did 20 years ago.

And I think that when you have shareholders who are pushing for something more immediate, especially when they think that they can invest those funds themselves for a better return than letting a company make that investment decision as long as that's driving a lot of these decisions, it's -- can be very, very problematic. And you're seeing that in a lot of situations where people say you short play companies instead of conglomerates or, you know, we have seen arguments being made in the E&P industry that company should be focused on single basins and companies are focused on multiple basins are not going to be as efficient. And -- and therefore you should split these companies up and do other things.

I don't think that makes enormous sense, but part of it is -- it's a -- it's a much bigger issue. It's not a simple proxy fix.

CROZIER: Can I just clarify one thing? I don't mean to imply by using the term collusion because, of course, it'll become very prevalent ...

(LAUGHTER)

... in our political discourse. I don't mean to imply anything anybody doing anything improper. Cooperation would -- substitutes for that in my mind.

SHEEHAN: Lisa? And then I have something.

FAIRFAX: Thank you. Right? And thank you for all of your remarks. I actually was on the panel that focused on universal proxy. And my recollection of that conversation was that it was very different from the one that we are having here today, and that there were some significant pushback around whether or not it made sense to adopt a universal proxy card and around whether or not it made sense to engage in an effort at changing the proxy system without doing it wholesale like that we got -- I felt like there were a lot of questions about don't we have to do it all at once.

So, I guess the first thing I would say is I'm heartened by the notion that it seems like we've come to a place, number one, where people feel like we need to start taking steps, that we need to start, you know, getting the low hanging fruit and -- and create, I think as Heidi suggest some short, medium and long-term strategies about how best to -- so I guess a little bit of what I'm doing is what Damon was trying to do is to say so have we come to a place of consensus around let's try to get some movement around changes to the proxy system and not kind of wait for the wholesale solution.

I guess, the second I would say on the universal proxy card piece because I -- I do think this is a very different conversation. I feel like both from industry side and from regulators side, and so now maybe it's just a level-setting exercise as Damon was trying to do. I guess, I felt like people listen to this conversation today. They will walk away with the assumption that everyone was on board, right? This is not something, yes, there are doubles in the details, but this is not something that's going to require some significant overcoming of obstacles in order to move forward.

And I just want to make -- get your understanding of whether or not you think that is true, that is are we out of place where we really can move forward on this issue and focus on the details, right, 10, 20, 75 percent, or should we expect that there will be some type of significant pushback and, you know, what would that look like. That's s my first question really.

And then my second is on the OBO/NOBO. My -- my research suggest that most people don't understand this distinction. Most people ride -- don't -- like the defaults don't appear to be working because most people are defaulting into places. They do not understand they're defaulted into. And even the ones who have some

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

understanding that they have defaulted into this don't fully appreciate what it will mean come proxy voting and proxy contest voting.

And what I -- when -- so when you got started and we need to change the system, we need to get more, I'm wondering is that is true or is it case that we need to get to a place where we recognize that at some level maybe that distinction is not useful in some circumstances. And that, you know, when it comes particularly to contested elections and the need to communicate with voters, that it's not about trying to encourage more NOBOs, but it's another workaround. We need to figure out just how do we get to people regardless of their status.

SHEEHAN: Deborah and then David?

MAJORAS: Thank you, Lisa. To your first point, look, I can't pretend that I speak for all issuers. My only concern on universal proxy is -- is the devil really is in the details. In other words, it's not -- it's not just, oh, details, details. They really do matter. And let me -- let me give you an example of it from -- from -- from my perspective.

So, in -- in the current proposed -- the 2016 proposal, which would require that dissident to only communicate with 50 percent of the shareholders, in Procter & Gamble's case, that would mean that -- that a shareholder would only have to communicate with 124 shareholders. Procter would communicate with three million. So, we're -- if we think about -- and then -- and then if you would take -- you know, I was very interested in Ken's proposal, move it 75. That does change it. And it -- it will look like a bigger number, but it's still only two percent of our shareholders.

So -- so the -- so my only point is let's not -- we also want to solve the problem of not disenfranchising our retail shareholders and so if what we're saying is I want to get elected, but you don't count enough for me to send something to, I mean, we just have to look at that. We have to look at of all I think together. And as David, I think, pointed out earlier, if you look at the fairness, too, to the -- to the issuers in terms of -- of piggybacking on the expense and -- and -- and so forth, so I just wanted to put that out there when I -- because I kind of whispered to David's point, well, sort of, and it wasn't fair of me to do that. So I wanted to say ways to that.

So just -- I do think that the details matter here and that we need to think of them. And then on -- what you said about the OBO/NOBO, I like it because what I think -- partly what I heard you saying is let's understand what the facts are and what's going on. And -- and there may be -- there may be easier fixes to that that really involve just education, making sure -- because let's face it, we all have defaults opt-ins/opt-outs in our life today, and we just -- we just breeze right through them, so it's probably a good idea to start there.

SHEEHAN: Yeah.

KATZ: And I was also on the roundtable with -- and I do think that there are still issues. I am heartened, you know, from the discussions that have happened in the last two years that there is more receptivity to the changes that, I think, would -- would level the playing field. I still strongly believe that you need to reform the whole system because the universal proxy is going to be working within it, but are we better off by taking that step if you make the modifications that you need to make.

I think that we would have a better system. I have also seen two more years of, you know, bad outcomes on votes because a proxy advisory firm recommends, you know, one dissident out of four, but all four end up getting elected. And people say, "Well, I didn't have a choice, I could only vote on that one card." And so by voting on that one card it has a contrary result.

And when -- you know, that can happen much more easily than people suspect, and it does happen -- I mean, I have now seen it in -- in more than a dozen cases and different situations, and it's very hard to explain to the management team. It's also very hard to explain to the management team, you know, how you're going to visit a large shareholder and you find out that they only -- you know, because they've lent out the shares, frankly, they don't tell you but they are voting nowhere near what that ownership is -- is going to be. And that -- that can also impact.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

On the NOBO/OBO thing, to me -- to me, I don't think you're ever going to have to really educate the -- the person that you're most interested in educating the retail shareholder on this because, you know, when they sign up for whatever they're signing up or however they invest, it's s not really well-explained. I do think that this is an area where, as part of an overhaul the rules, this is something that's s really worth looking at whether in particular situations it make sense or not. You also have to deal with privacy issues that exist.

And I think a lot of people still make their distinctions about whether they want to be an OBO or not because they -- they perceive it as a privacy issue and there are ways to deal with limiting what that information to use for and when that information can be used. And I think it's s a mistake to sort of say, "Well, let's s educate people on what the system is because I think even if you educate them, you know, much the same way as I have enormous promise that only 25 percent of retail holders are voting, it's s a big issue to me. That's s why I think that, you know, both sides in order to use universal proxy they should have to go out to all shareholders. All shareholders should be given the same amount of information.

I don't think that is a big change to be honest with you. I -- I think it's s more of a fairness issue. But, you know, to me, those are the types of details so that I think can -- can be done serially although you really do need to fix the system because if you just fix pieces of it, you're going to create different tactics and -- and proxy contest issues.

SHEEHAN: Thanks. Okay. So we've got Allison -- oh, Arthur, go ahead.

CROZIER: Just to follow up on something David said. I mean, I think on the NOBO/OBO, at least from our experience, I mean, we have to recognize there are individual holders who do not care and they will not vote no matter what you do or what process you set-up. I mean, that's s just the reality. We can't get 100 percent participation.,

SHEEHAN: Okay. So we've Allison, John Coates, Lydia, and then I'll see if folks on the phone. I know we -- we've got a couple of more folks who are going to testify, and I'll have the -- you folks just stay at the table and bring up the others, and then Ed Rock is coming in video -- video conference.

So, Allison, you are up next.

BENNINGTON: Thank you, Anne. Really all I wanted to do was back up here for a second and underscore why this really matters and why this is so important. We've been talking about a lot of detail here. I just want to sort of remind everybody the -- the basic corporate governance concept here that we're really talking about, you know, which is accountability. And it's s accountability all the way up the chain in corporation employees being accountable to management, manageable management being accountable to the board, and the board members being accountable to the shareholders. And how does that happen was the mechanism that -- that the relationship between the shareholders -- and we're talking about all the shareholders, whether we're talking about somebody that holds one share, somebody that holds a million shares, and that's s the ability to elect the directors of the company.

So -- and this is the mechanism that it gets done by. It is the proxy process. So I -- I just want to make sure that, you know, in all the detail we don't lose the fact that this is a really, really important topic and to make sure that the people who actually own the shares are the ones that are electing the directors and, therefore, that chain of accountability is intact.

So I only have one question that's s really simple. And I want to ask Deborah and actually want to ask the same question of Matt, so -- yeah, you're on the hot seat ...

(LAUGHTER)

... as representative issuers. What percentage of the -- of your corporate business communications do you think occurs -- and I will say your important business communication occurs through U.S. mail? I'm surprised you have to think that much.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

(LAUGHTER)

Yeah.

MAJORAS: The reason I'm thinking that much is because I'm trying to think of any.

(LAUGHTER)

(UNKNOWN): I was going to ask there still is the U.S. mail. I didn't realize that.

MAJORAS: You know, I am very, very little ...

BENNINGTON: Yeah.

(UNKNOWN): Yeah.

MAJORAS: ... very little.

(UNKNOWN): Same, same.

BENNINGTON: So that's -- that -- that's obviously the second point I wanted to underscore. Thank you.

SHEEHAN: Great. John Coates, did you -- Okay.

COATES: Yeah, real quick. So first business roundtable was wrong than it was decided and it's even more wrong today, so nobody should pay any attention to it. Honestly, I really do think the current D.C. Circuit wouldn't even given it a serious view as precedent and create legal advice.

E-communication, if permitted, and we heard about the fact that I guess, Broadridge bans it. How do they do that? Why don't the issuers all band together and tell Broadridge they can't do that. In any event, I don't think it's an SEC rule unless I'm missing something. If you have that capacity, that would reduce the asymmetry that David and Deborah were flagging from universal proxy, right? So the need to reach all shareholders becomes much less asymmetric if you can use electronics to do so. So there's a linkage between those two things, aybe universal proxy coupled with the change, and that would be much more.

And then, I guess, just -- you know, more broadly given that Broadridge is a monopoly as we heard, do we like monopolies? Does anybody like a monopoly? Would there be appetite for there being, too?

(UNKNOWN): Yes.

COATES: Would there be a role -- I realize the SEC is not an anti-trust regulator, but the rules that structure this set of interactions do create barriers to entry and, therefore, perhaps entrench monopolist. And I guess therefore should the SEC, as part of this, be thinking hard about ways in which its rules make it hard for someone to compete with Broadridge. Anybody want to take that one?

BERTSCH: Right. I think we should be very clear on what part of the utility function may be a natural monopoly. And I -- and, you know, David suggested more -- there maybe opportunities for more competition. I suspect there's maybe a core function that is very utility-like and probably should be regulated like a monopoly. So at least we can be clear on what -- what that is. I don't know if that helps.

SHEEHAN: Well -- and, Lyell, I know you'll have the opportunity when you come up to address the issue ...

(LAUGHTER)

... so I think you've got your questions ready. So, we will call on you because I -- you know, you are going to get the question on the mailing just we can recognize that.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Lydia, you've got a question.

MASHBURN: Thank you, Anne. My question follows a little bit on what John Coates was just discussing, but to what extent could we -- this is a very complex problem, complex system we're talking about very specific details that are causing challenges with the way the whole proxy system is working. To what extent could we move to a more principles-based approach in the rules and regulations governing the system such that whether it's the SEC or other involved regulators could say, "Here are the goals of the system and then allow the marketplace to figure out multiple solutions." Usually the best way to find the best solutions is to put multiple ones out there, and let there be a competition of types of solutions to the proxy process.

And there could be multiple technologies, different technologies, David, you were mentioning. What are the things we can do to help us move in a direction where we could actually try to solve this problem creatively and bring in the right players who are incentivized to solve this problem? Because I do think it's hard for a group of us in -- in a room here to say, "Oh, we're going to fix it this way."

There are lots of solutions to this problem. It's not just about disclosures, how to change the way in which we communicate with investors, et cetera. There could be tons of things we could do differently. So how do we make that? How do we open up that process?

KATZ: I think -- and -- and responding somewhat to John's question as well, I think there is a way to open up the process. The -- the key though is if, for example, the SEC mandated some type of blockchain technology tracking and et cetera so that you could actually confirm the vote and -- and -- and follow it, I think you could allow competition to see which system work best.

My concern though is you have to be very careful that, you know, if -- you know, issuers may move towards one system and activists may move towards another, if you're going to have competing market models of how it would work in practice and the cost frankly will be borne, at the end of the day, by shareholders, not necessarily monetarily, but you're going to have some outcomes that are sub-optimal. And I'm just not sure that it's worth that. I do think we are in a sub-optimal area right now and there are some fixes that we make, but I think that there are -- by mandating some technologies and letting the best technology prevail and -- and things like that, I think that you can go a long way.

As far as, you know, dealing with monopoly, et cetera, and dealing with the communications, you know, if it's part of a brokerage account and -- and systems like that you could be mandated to give an email address or something like that or we could come up with a better system, you know, that -- and people would have to re-up annually or something like that to make sure that they were getting the materials, you know, maybe something like that can then allow there to be a competitive situation. But I think you be very careful because there's a -- you know, at the end of the day, the SEC is going to step back and it's going to be a state law issue where it's (inaudible) are fighting that whether it was a good vote or a bad vote, and -- and how -- and you just have to have the right steps taken to do that.

Now, Art, I don't know from your perspective whether that's complicate matters so much that you think the system breaks down or you think that, in fact, you know, will maybe a little bit of competition will help raise the bar.

CROZIER: No, I -- I do think a little bit of competition would help raise the bar. I mean -- but, you know, the problem I think is -- as somebody alluded to earlier, there are so many different participants in the process that I think you really need some kind of central regulatory system to get all of those participants in the process onboard and moving in the same direction. And state law is going to complicate things.

Most -- most companies are -- most publicly-traded companies are headquartered in -- in Delaware. There are always still going to be issues about validity, but you also have a number of companies who are incorporated in other states that have laws that are different from Delaware and will have to be applied separately.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

MAJORAS: I think I just want to clarify that my question is more about could we move to a regulatory framework that is more principles-based instead of mandating a technology because I think evidence has shown that when we pick one technology, technology changes and it's outdated. Snail mail used to be efficient.

KATZ: Look, I would love to say that you could -- that a principles-based system could work here. I just think that a principles-based system without the specificity and the rules that would -- you know, isn't going to work at the end of the day. And if we're going to -- the difficulty is if you really want to have a level playing field for both, you know, that treats issuers and shareholders and different types of shareholders the same, unfortunately, you're going to have to get beyond the principles.

MAJORAS: Okay. And I -- I agree with David to some degree that -- that some rules may be necessary beyond the principles. But Lydia, I do agree with you that -- that it tends to be bad business for federal agencies to dictate a particular type of technology that should be used, right? And there -- there should be some broader terms that can be used about electronic means or -- or whatever as opposed to -- because you're right, we'll be sitting here five years from now and with technology moving as quickly as it is we may be talking about blockchain, we may be talking about something else and we haven't conceived that yet. So, I -- I do want to say that I -- I at least agree with that -- with that point a little more narrowly.

SHEEHAN: Do any of the IAC members on the phone want to ask a question at this point in time? Okay, it doesn't sound like it.

So, what I'd like to do is call up the next panel. The current panel can stay. I don't know. Stephen, you want to put them on there. And then we also should have Professor Rock. So while we're checking the technology link, why don't I go ahead and introduce the second panel quickly, and then turn it over. Professor Rock will be our first speaker.

So, Ed Rock is the Martin Lipton professor of Law at New York University School of Law and also the director of the Institute for Corporate Governance and Finance at the same university. Long ...

ROCK: (Inaudible), right, right.

SHEEHAN: Long history in the corporate governance area and really one of the experts. I think the Committee got a copy of his hanging chad paper sent around, which for some was sort of the seminal work on this whole issue. So, and then ...

ROISMAN: (Inaudible).

SHEEHAN: ... Lyell Dampeer from Broadridge, President of Investor Communication Solutions at Broadridge Financial, responsible for Broadridge's U.S. regulatory communication services and its issuing transfer agency. So I -- Lyell, I know you're going to have a lot of questions. And then finally Alexander Lebow, cofounder of SAY. He is the Co-founder and the Chief Legal Officer of SAY, Inc. SAY is a New York-based technology company, speaking of technology, built -- that is building tools for shareholder voting engagement and education. So we look forward to hearing about that.

Unfortunately, our NASDAQ witness John Zecca is unable to attend. He came down ill last night and is not able to travel, but we do have his statement and it'll be posted on, you know, our website and the committee members. So -- and it's unfortunate because NASDAQ did have an experiment. They had done some work in both Estonia and South Africa on the very issue of blockchain. So I would prefer the members of the committee, as well as others, to the statement that they had submitted and the experience they had there.

So, let's -- while -- while we're checking to see where Professor Rock is in terms of -- Stephen, do you know if Alex's -- Okay.

So, Lyell, why don't ...

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

(UNKNOWN): Five minutes.

SHEEHAN: Five minutes, Okay. So, Lyell, why don't you go ahead and do your statement? And then if he comes on at the conclusion then we'll go to Professor Rock. And then, Alex, we'll go to you. Thank you.

DAMPEER: Well, good morning.

SHEEHAN: Thank you.

DAMPEER: And thank you for -- thank you to the Investor Advisory Committee and the SEC for allowing me to participate in this roundtable. I must say it's s very exciting for me to be in a room full of people that are actually interested in what I do. It doesn't happen very often. And I look forward to the robust discussion. And in my (inaudible) ...

ROISMAN: (inaudible) I ...

DAMPEER: ... I have modified them or will modify them to try and answer some of the questions and issues that have been raised particularly around the issue of low hanging fruit and our perspective on that.

I do want to start by saying the U.S. equity markets are incredibly robust, powerful and they're also complex. And the shareholder communication and proxy voting process must reflect some of that complexity. Understanding that complexity, I think, ends up being very, very important to understand how the process accommodates that. So we welcome this opportunity to provide some insight as to how the process works and data as to the functioning of that underneath that.

I will touch on some of the comments around empty voting, share lending, chain of custody and so on. The -- I -- I do want to say that the aspects of the shareholder communication proxy voting process that Broadridge, with its bank and broker clients, has been administered over the last 30 years is accurate, secure and efficient. For over 30 years, the system is proven his flexibility to handle expanding needs of participants and regulators. Thirty years ago, probably none of the questions raised today were even in anybody's s mind. They're very, very important today.

We have willingly subjected ourselves over 25 years to independent third party oversight of our activities starting the suggestion by the SEC itself in 1993. They instituted the Independent Advisory Committee -- Steering Committee. We've had that in place for 25 years. It's s shared by an independent chair. It has representatives of the bank, broker, the shareholder and investor communities. it oversees our activities. It also has participation now from the CII and the -- it's s formerly called the Society of -- well, now the Society of Governance Professionals.

We have independent audits performed by Deloitte & Touche annually on the process and compliance with NYSE and SEC regulations in the proxy process. And we provide quarterly vote accuracy reports for the process for street voting. We do that also for registered voting. When we do that, the information is made available to the NYSE. It's s made available to the SEC. It's s made available to our steering committee and to anyone else upon request.

We also are subjected to hundreds of individual audits annually by banks, brokers and issuers who visit and/or question our capabilities around processing, accuracy, timeliness, and also security, data security, physical security and vote security. We're probably unique and that we're (inaudible) probably more than any other financial or financial services institution in the world because of that relationship. And I do want to mention that Broadridge has no economic interest in the outcome of any of the meetings or contests that we're involved in.

We estimate that the investment that we, with our bank and broker partners, have made in this process over the years is well over \$1 billion. We are continuing to invest particularly in cybersecurity at a fairly high rate. It's s incredibly important. Some data points that support the benefits of investment and technology, as we report in our proxy -- ProxyPulse paper that we published this past proxy season, we eliminated the need to send physical material to 76 percent of all Street positions. Seventy-six percent of all Street positions were not communicated by



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

paper, notice or full package. We estimate the annual savings to issuers as a result of the elimination of print postage annually exceeds \$1 billion, and that number has continued to grow fairly substantially over time.

And lastly, I want to note that 95 percent of all shares voted this past proxy season were voted on electronic platforms. Ninety-five percent of all shares are voted electronically.

We've been involved in technology and the application of technology as rules have allowed and as technology has evolved. I'll give some examples of those. We implemented phone voting. For those who remember what that is, it's 20 or so years old. We used to support that touchtone -- I'm sorry, rotary phone dialing up phone voting at one time. None of you would know what that is, probably I do.

Internet voting, mobile voting with responsive design, meaning that it renders properly on whatever device you have. We've implemented QR codes. For those of you who know what a QR, quick response reader on your phone. We have integrated directly into broker websites so that when you log into your broker site you can access all shareholder communication. You can vote on that site. The control number is embedded in that communication.

We've done e-delivery for many, many years. Again, the control number is embedded in that. You do not need to take another step. You can vote right there on your phone or wherever you happen to receive email. We integrate directly into broker apps. So if you use an app instead of the broker website, we integrate directly and can present communications and allow you to vote through the broker's app.

We now -- we can do distribution true cloud channels as they evolve. Examples are Google Drive and Dropbox. We can distribute communications directly to those digital channels based on the investor preference.

We do support universal ballot. We have processed universal ballots, so technology supports that. I think perhaps it was Arthur noted that the technology allows, in -- in electronic form, the prevention of voting for more directors than you're allowed to, for example. It's still a problem if you do vote on paper. We've built very robust portals for banks, brokers and issuers to allow them to access information real-time necessary to the performance of their meeting duties and/or their regulated responsibilities.

We are, right now, in -- in beta doing text distribution and text voting. There's some security issues, but we're doing that. We have allowed the use of social media now for issuers to communicate during a solicitation on social media. We'll continue to explore that.

And some of you -- some of you may know, we have built production, distributor ledger or blockchain environment for proxy voting. We have done proxy voting in U.S. and non-U.S. meetings over the last two years. We will continue to do so. And I'll comment on that in a few minutes. That said, we do think that there continue to be significant opportunities to enhance the process through technology, but I think also through education. I'll comment on four of those though.

The first one is a reconciliation of voting entitlement prior to the meeting date. Now there's been a lot of discussion about that this morning. The reason that this is complicated and it mirrors the U.S. equity market process. There are multiple record-keeping systems in the U.S. There's the transfer agent, the bank and broker record-keeping system on behalf of the clients. You have the central depository like DTCC, and you will have investors as well, particularly institutional investors, will also have record-keeping systems. Those do need to be reconciled on a real-time basis for this process to work well.

I think what's not clear, but I do want to make very clear, that information to do that reconciliation is available today. It is available to tabulators and it is available to solicitors in the case of contest. You have a tabulator in all regular annual meetings. You have solicitors representing both sides in the case of a contest that ultimately -- the information that eventual ultimately aggregated at the inspector level. But the information on all of those cases today to determine who has voting entitlement, whether or not shares have been lent, whether those rights have gone and whether or not the chain of custody is broken, all of that information is available today.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

We led an industry pilot two years in a row to demonstrate that, in fact, this is possible regardless of the constituents involved. It's not a Broadridge-specific process. It -- some people in this room, I think, participated and were aware of that. We demonstrated that through the information available today, all of those things can be identified and they can be remediated in advance of the meeting.

All of this is possible today. We did build at our expense where we called a communication tool that provided the constituents. This would be transfer agents, tabulators, DTCC, issuers and so on to not only identify, but then pass information between those various entities to attempt to remediate brakes or clarification around entitlement. That's all possible.

The thing that I -- I do want to point out, the information is available. I think most people that are in the -- in the plumbing as I am understand that. That information is not used today. I don't know why it's not used. It is only used after the fact to point out that there are problems with overvoting. That seems disingenuous at least because the information is available, can be used, and you can get that reconciliation.

The information is available shortly after record date. The average solicitation in the United States is about 45 days. There's plenty of time to do this.

The industry pilot has demonstrated, in fact, it's possible but you need all players to participate. It's not just a Broadridge, it's not a monopoly kind of discussion. Everybody simply needs to participate. The fact that it's not used -- again, I'm -- I'm -- say again I think this is ingenuous. This can be accomplished today through cooperation and does not require any regulation.

The second thing I'll talk about is vote confirmation. We have been providing vote confirmation for 10 years or longer. So this idea that vote confirmation doesn't exist is not true. It's just factually not a true statement. We do provide confirmation. We are only able to do it though today when we are the tabulator, so we have the information necessary. We do tabulate U.S. meetings, not just on the Street side.

When we do that tabulation for over 10 years, we provide confirmation to our institutional users on our proxy edge platform. It can be done, and we have also provided confirmation to retail and registered shareholders at the request of the issuer. Technology allows that. It's a very straightforward process. It does require this reconciliation to take place.

And in the industry pilot that we ran, we were able to do confirmation across the industry for all constituents. It is not a process depending on a single actor. That's very, very important for me to know here. That should be done. We believe confirmation should be done. It does require everybody to agree to participate. It's not that complicated. It's a very straightforward reason -- a very straightforward process.

And I want this group to understand that this is easy to do. If there's anything this group could do or the SEC could do it is to encourage or perhaps require that the constituents that participate in this process, in fact, engage in reconciliation and engage in vote confirmation.

Technology allows it. It can be more sophisticated than it is today. When we do provide confirmation today, we're doing it electronically so that nobody is paying to send out something in the mail. That's a possibility, but that incurs significant incremental expense. So we do support confirmation. We think it should be done.

The third comment I would make is around shareholder engagement participation. I think there is sort of a balance between how do shareholders do they want to be communicated with, particularly retail holders? And if so, how do they want to be communicated with?

Certainly, we would all agree that the technology today through multiple channels, and there's paper, there's traditional email, you have text, social media and cloud channels and probably other ones evolving in the near-term. But technology can create innovative and customized experiences to communicate right down to the individual shareholder. Just like you go on Amazon, they'll tell you what you should buy. The same kind of idea,

# SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

although a little spooky may also apply in this case. Technology allows that today, so it creates really exciting opportunities to drive engagement and participation through technology, but the shareholder today must consent to receive things in electronic form.

That's not the case. Registered shareholders are consent to receive materials electronically. Maybe 25 percent of the time is more like 15 percent of the time that shareholder -- registered shareholders even consent to receive things electronically. On the Street side, it's probably north of 65 or 70 percent. The brokers have done a much better job of encouraging participation for receipt of electronic materials. That needs to be dealt with simply saying that technology will solve it, but the shareholder not willing to receive it that way prevents that from being an avenue.

We think incentive fees, the regulator incentive fees are on preference management and enhanced broker and a platform fee that was instituted in 2014 have had an impact because it's incented brokers to -- to gather consent, not only email address but the actual consent currently required so that all issuers collectively benefit from that ability to communicate.

I want to point out that when you send some comments about having to get control numbers, all of that is exactly right. If you get something in the mail, you can vote on the VIF. You can send it back. You can go to a website.

If you get a notice in the mail, you have to go to the Internet and enter your control number. If you lose that notice, you don't have a control number. If you receive something, an email or the other digital channels, it's an -- the control number that you need is encrypted and embedded in the email, so you don't need to do anything other than click. It takes you right to the voting site. The unique identifier presents you with the agenda and so.

So I think understanding that the investor needs to be persuaded and the ones that have been most successful, the banks and brokers in persuading investors to receive material electronic -- certainly, it's in their own interest as well so they don't have to send your physical statements. But it is not universal. This idea that it is universal is actually the facts don't support that right now.

The fourth comment I'd make is around distributed ledger or blockchain. There's certainly been comments about that. We believe that it's an ideal use case. The annual meeting process for the reason I already cited around reconciliation. It requires for the process to work real-time reconciliation of disparate record-keeping systems. It doesn't require all the systems themselves, the record-keeping systems to move the blockchain. It does require that those participants that have those records agree to operate on a shared distributed ledger. If that were done, you would get the reconciliation, and again all constituents can participate.

There are other service providers in our space. We are not the only one in here, so I -- I won't accept the M word today. But there are other service providers. If all are willing to participate, blockchain is a solution.

We have processed U.S. meetings and non-U.S. meetings starting in May of 2017, so the technology works. People have access to that. You create immutable record of entitlement of voting and results. All of that is correct, all of that is true. We're going to continue to invest in this.

But the value is only going to be recognized when all the constituents, in fact, agree to participate on the ledger. And that's -- that's technical work for people. Those of you that are familiar with the technology, you need to operate a node. Even on a private chain, you need to do -- excuse me, do work in order to validate, build the blocks on the shared ledger.

To date, unfortunately, Broadridge is the only in these meetings that has actually done that. So while it is distributed ledger technology, the ledger, frankly, is only distributed to Broadridge

We need other people to participate and we would encourage that to happen again. It doesn't require regulation for this to take place. It requires encouragement. People could be mandated to use that.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

I will comment from a retail shareholder point of view, which is a little different than the use case in Estonia that NASDAQ would have spoken about, but there you have a digital ID. If you can imagine now as a shareholder that you have a digital ID and it could be provided by different service providers and you need to get that particular secure digital ID because it's not going to be sent to you because it needs to be secure. You need to go find that in order to vote.

There's a -- there's a challenge there. If you think about retail participation, you may potentially be adding another step to that. That needs to be understood and do the current voting platforms continue to exist, but perhaps the recordkeepers and the issuer contribute directly into the ledger, meeting date, record date and so on.

I also want to comment on this -- the record date comment share lending. The -- the record dates in the majority of cases the United States, in fact, are known in advance. Now we provide that information today to our custodian banks and brokers. That -- that information, the record date is known in advance. In almost all cases, I'm sure there are small-cap companies where it's not true.

We -- we have -- we do provide this information, particularly the custodian banks. They have large institutional investor -- the large institutional shareholders because they do need to know this to manage their share lending activities. That said, our experience has been that absent the agenda, which is not known in virtually any case before the record date, not knowing the agenda, it doesn't do a lot for institutional investors to say, Okay, here's the meeting date, I want to call my shares back, but do I want to call them back if there's nothing of substance on the agenda.

Again, you had cited the example of calling back in all cases because you don't know what's on the agenda. So, the timing is still a little mismatch. Record date is known in advance of record date. Agenda is known after, so maybe there's a way to think about that.

The comment about electronic delivery on contest, and I'll say certainly shame on us that that's not available. It's -- the reason it's not available -- because they had never been asked. In 30 years of doing this, there was never an instance where an issuer or solicitor asked us to send contested material electronically because, as Arthur said earlier, the -- if you want somebody to vote, historically, you sent the holder a retail or a registered holder a full package. The likelihood of voting is substantially higher.

No one, issuer or solicitor, until the ADP and P&G contest had ever asked us to do this; we didn't build them. We are building it now. We'll absolutely have it. We didn't build it because there's no demand. There is the demand now.

Arthur's point, I think, is very important though. Notice an access on the retail shareholder participation has been reduced significantly. E-delivery is not necessarily driving that to new heights. It's not driving participation to new heights. They are voting actively and they -- e-recipients voted a higher rate than mailed notice recipients.

But there is a knowledge that mailed notice recipients don't vote. I think something like under five percent of all retail holders that receive a notice actually vote. It's been known that -- that -- that was the information we had provided in advance of the rulemaking in 2007, and that's still the case. I think issuers know that, so it -- I think knowing those facts that people can modify the way they wish to solicit and communicate with the shareholders, the technology is not an obstacle.

I'll stop there and be happy to answer other questions.

SHEEHAN: Thanks. Thank you. Professor Rock, I believe should be with us. I know he's on the phone and he should be also on the (inaudible).

ROISMAN: (inaudible). Can you guys hear me out there?

SHEEHAN: We can hear you. You may want to speak up a little bit.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

ROISMAN: Okay, Okay. It is -- it's a pleasure to -- to be with you today unfortunately because of (inaudible) of good technology, I can actually see you, but I've been listening in. And -- and I know a bunch of my friends is out there, so hello everybody.

This is -- this is a topic that we're so converted I have been working on for a long time. We published an article back in 2008. What's so interesting is that none -- none of the problems we identified then have been solved in the -- in the interim.

What -- what's really interesting to me is the sort of story that we never took different periods for -- for the earlier (inaudible), story about the overvoting and (inaudible) where there are 80 million votes cast even though there are only 60 million shares outstanding as a (inaudible). This (inaudible) a story, simply a story that I heard from Brian Schorr about Procter & Gamble about the investor with a large bank who casted votes, and they weren't counted. And they weren't counted because there was a problem with the custodian having changed its name or having merged. And it turns out they hadn't been counted for 10 years that nobody had told the investor that the shares went up the accounting.

And when you think about the system, I wouldn't really think of the point (inaudible) in the discussion earlier. I think she's right that we don't want to be talking about what technology is the right technology to use because none of us know very much about technology and technology changes.

I think the (inaudible) is sad to say what do we want from the voting system. What's the minimum that we want won in terms of a building system. And that's something I think a lot of us could contribute to, but my -- my basic sort of (inaudible) in the back of an envelope of what I would like for the voting system it starts with a preliminary shareholder list the week before the record thing so that shareholders would be able to check their positions to make sure that they are what they thought so there's time to fix things such as a wrong name to recall shares that are out on loan or whatever. And I think Lyell makes a good point though, you don't get to have the agenda prior to the record date so you could make an intelligent decision whether to call back shares.

(Inaudible) record date, shareholders should receive a unique voting code. There are obviously security considerations and making sure that we can do that in a secure way. And then the voting code should allow shareholders to go online and cast their votes using the code is an immediate indication that the vote has been accepted or rejected by the tabulator.

If a shareholder changes his or her mind, the shareholder should be able to go back online and change their vote. And if the vote isn't counted, the investor should be paid back and given a concise reason so that he or she could -- could fix it going forward.

These are -- this is a lot to add. In a central security depository service system, this is a pretty straightforward to deliver. We have the system we have (inaudible) people know. And (inaudible) but it's not that hard. We buy things on Amazon every day. And the technology is there. It's a question of figuring out how to apply the technology to this -- to this day and age.

There is something we clearly one company out there that have delivered this if they are also providing the tabulation service. And you heard from Lyell a minute ago that -- that Broadridge can be delivered. I have absolutely no doubt that it was (inaudible) integrated into the tabulation and in the sector of election (inaudible) that they could deliver this.

The problem, of course, is a problem that John Coates raised is that Broadridge is a monopoly. I don't have -- anybody has their favorite story for how Broadridge has abused its monopoly position. I don't have particularly (inaudible), but I -- by -- one of my other subject is antitrust and I -- I am not a friend of monopoly, and it's -- it's a problem.

The one question going forward is -- is if we set-up a system on which Broadridge does become the engine for providing us that there's minimal level of -- of voting system robustness to deliver what we think it needs, how we

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

handle the problem is monopoly? And (inaudible) serious problem because I think a problem the SEC should worry about historically. Remember the SEC's first chairman or second -- the third chairman has been manipulated, but the second chairman is William Douglas who was a -- a (inaudible) of antitrust and authored many of the great antitrust opinions.

And antitrust is the fourth pillar of the SEC's -- the SEC's mission, so the SEC should pay attention to the competitor concerns and figure out how consistent with fixing the voting system which may require at least at this point using Broadridge to provide the service to figure out how to open up the space through competitive solutions using alternative technologies because, you know, they are out there. There are people who know a lot more about technology than many of us who, if given an opportunity, to compete in this space would.

It's not I think technologically a hard problem to solve, so not as hard as a lot of what we take for granted today. And I think it seems that Douglas had pointed out requires for its basic legitimacy that we let people vote and that we know what they know that they have voted and their vote is not counted. And if there's a problem in the system because of some merger of some custodian that leads to a problem that they're voting they should find out about it and they can (inaudible).

So let me stop there and yield it there.

SHEEHAN: Thank you. Despite our technological challenges, we appreciate the testimony, speaking of technology.

Alex, I will turn it over to you. Thanks.

LEBOW: All right. Thank you very much and thanks for having me. It's great to be here.

It's been just over a year since my partners and I started SAY. And when we -- we would talk to people about we are working on -- proxy voting, shareholder communications -- people would frequently remark about what a -- what a complex eye glazing arcane corner of the financial system you've chosen to focus your efforts on to which we would reply exactly, that that's exactly right and that's -- that's exactly the point and that's exactly part of the problem that needs to be solved, that this is a system that's long overdue for reform. It lacks transparency. It lacks accountability, auditability. It's extremely complex and -- and perhaps, worst of all, extremely costly.

And despite all that, to echo Allison's point, it's actually a really important system, really important that it works well because it's the principal avenue for the exercise of the shareholder franchise in the United States, which is something that is -- is very important. To quote -- quote from Chancellor Bill Allen, "It is the ideological underpinning upon which the legitimacy of directorial power rests," which is a great theoretical quote -- then Chancellor Bill Allen, I should say. It's a -- it's a great theoretical quote, but it has important practical implications, particularly with respect to mainstream investors who -- who don't participate in the proxy voting system to any meaningful extent as it is today. And so the question is what is to be done. And I'm very pleased to be hear today to offer a few observations and suggestions informed by my experience dealing with the system firsthand and helping to lead a new entrant into the proxy processing and investor communications market.

So I'll start with a little bit of good news and people have used the term low hanging fruit a bunch today. I do -- I do believe there is a -- a lot of low hanging fruit to be had in the form of first basic technological improvements and -- and second, simple rule changes. And so I'll start with basic technological improvements.

I think we all agree and we've all heard today there's a -- a shocking deficiency in the types of technology, really lack of technology that's being employed in the system. And I'd say we have the opportunity to look anew at the system and do things like utilize APIs as opposed to older, slower methods of communication between entities. We've develop directly for mobile environments, employed basic principles of user experience and design.

And the -- the returns have been promising that we've seen increased engagement, things like lower delivery failures and hence, lower costs. And there's a lot more that we're doing and a lot more to be said on that point -- on

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

that point, but I also want to mention the opportunity for -- what I think are simple rule changes to encourage market-based reforms in the system.

And one thing that we haven't talked about today is the -- the processing fee schedule and the incentives that it creates, which I think frankly are bad incentives for the market and that it incentivizes distribution over voting and engagement. Just take an example, imagine a -- a mutual fund doing a -- a shareholder vote to amend its governance structure in some way. It's well-known this is a -- a pretty painful and expensive process for mutual funds, particularly with a lot of retail ownership.

And if you think about what's happening here, you know, the more that needs to be sent the higher the total cost in the fund, obviously. So the lower -- the likelihood of people actually opening and voting, the more reminders need to be sent, the more mail needs to be sent, and then the higher total cost on the -- on the fund will be, which doesn't really make sense. Those incentives should be realigned to encourage voting.

For example, this is just a proposal. Take a portion of the current fee schedule and have it only be collectible upon receipt of a vote and leave it up to the -- the market participants, to people who create the voter instruction forms and so forth to figure out what -- what methods and care can be taken to actually encourage, incentivize their presumably desirable behavior of people -- of people voting. So I'll move on. There's a lot of other line, so I'll move on from that. But I do think most of us would agree there's still some big reform that's needed in the system. And -- and some of you maybe wondering, so I'm going to talk about blockchain. And the answer is yes.

But I'll say -- I'll say this, I would be aware of the -- the blockchain silver bullet. I think there's no doubt that the technology holds great promise for its potential applications in the space. But I keep two of the question in mind. First question, how will the blockchain be governed? And second question is what -- what advantage does blockchain technology have over pre-existing database technology?

So, first question, how will -- how will it be governed? When -- when people hear the word blockchain, they -- they picture this decentralized trust list egalitarian system where anyone can join and participate and there's no central authority. And that's sort of public blockchain is exactly what underpins cryptocurrencies like bitcoin and ethereum and it's certainly a great innovation.

But for -- for enterprise applications like proxy voting, that doesn't really work because of the need to validate participants to ensure that only the right entities, brokers, banks, intermediaries and so forth are actually taking part, and that necessarily requires some degree of centralized management, unified single entity or -- or consortium of entities or perhaps a regulator to create and manage permissioning protocols, so this close ecosystem. And this is what's known as a permission blockchain as opposed to a public blockchain.

And that's -- you know, a big big question is who or what will have the power of creating and managing these permission protocols, in other words, of running the proxy voting blockchain. And in answering that question, I think it should be a top priority to distribute power and control and promote competition as opposed to allowing a single entity to retain control or take control over a new system and -- and perhaps be able to charge for access to that system.

Second big question about blockchain, what advantages blockchain have over preexisting database technologies? You know, when we go through all the technical qualities of blockchain, it's -- you know, it's decentralized, it's trustless, robustness, performance. I think there's no clear technological argument over -- for its superiority over pre-existing database technologies in this context. So the big -- big question is what is it about blockchain that people find so appealing apparently so enticing?

You know, I -- I referred back to Vice Chancellor Laster's great speech on that subject from 2016, and I found maybe the kernel of an answer if you allow me to quote two Delaware jurists in one speech. He said, quote, "The technology could reunite legal and beneficial ownership. Custodians become unnecessary. Ownership lies only with beneficial owners. A single distributed ledger would allow straight through accounting, a utopian vision of share ownership where there is only one type of owner, record owners."

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

So if you think about it, I think -- I think what -- what people are grasping for here has -- has little or nothing to do with distributive ledger technology itself and everything to do with what its adoption would mean for breaking this disjointed market of intermediaries, and Street name ownership, and NOBOs and OBOs, and the misalignment of interest and lack of competition that it has created. The prospect of changing that, I think, is -- is what's so exciting about blockchain.

So, think back to that mutual fund doing a shareholder vote and imagine that it chooses a proxy services provider based on the services that they provide from a healthy competitive market and it pays that service provider a rate determined by the forces of the free market. We don't need blockchain to make that a reality. It could come in the form of what Professor Rock has proposed a dematerialization scheme, a central aggregator scheme.

Blockchain is one -- one solution, but we don't need that -- we certainly don't need that to get there. And there -- there are other reforms that are much simpler, much more likely to be adopted expeditiously and they're based on technologies that have been in the financial system for decades.

So my final word for you to suggest to the -- to the Committee and -- and to everyone listening to is would be think about, you know, what it is we're really after and when we talk about blockchain and -- and think about this market and -- and just go after that directly. Thank you.

SHEEHAN: Thanks. Before I turn it to questions for the folks here, I'm going to ask our committee members on the phone if any of them have questions for the -- either the last two panelists or last three panelists or any of the panelists. Nope, Okay.

(UNKNOWN): None for me. Thank you.

SHEEHAN: All right. Okay. So ...

WALTER: None for me.

SHEEHAN: Not -- Okay. Thanks, Elisse. All right. So then we will go to the Committee members here. So, Matt, why don't I start with you and then we'll go to Damon and then Mina, and then J.W.

FURMAN: I'm curious, you know, that the Commission has lots of things on its potential agenda, lots of potential priorities and limited resources. Where would you put the -- the very significant changes that would be required to get to some of the -- the angles we're talking about? Where would -- some of the participants put that on the list of priorities that the Commission should have? Should this be, you know, very much near the top and have a -- a real push from the top to get done or is this or are we fixing a problem that is a very significant problem in the very unusual cases where you have a close vote, but maybe is fine, you know, other parts of the times. So just get -- one, get a sense of prioritization.

SHEEHAN: Lyell?

DAMPEER: Sure, awesome. Let me speak to that. If you think about reconciliation and confirmation, that's stwo of fundamental ideas that have been discussed on both of the panels this morning. I would suggest again that both of those are possible and they're doable today and they should be done today. I don't know if that requires -- it doesn't require new rules. It may require encouragement. It may -- it may be requirement that, in fact, the constituents participate in reconciliation and confirmation, but it does not require other rules to allow that to happen.

It should happen. It's s-- I think that should be at the top of the list to address the point that shareholders have a fundamental right to vote and to know that their vote counts. And it's seasy to do today. And this idea that it's svery complicated and everything needs to be changed -- things can be changed. I'm not saying that there can't be changes, but it would be a mistake, I suggest, that we don't get after those two things today because they can be done now.



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

It's been demonstrated in industry pilot with lots of participants. It's not that complicated. Yes, there's work to be involved in that. It should be done. It should be encouraged or required.

Reconciliation and confirmation does not require changes in underlying technology. Those could be used or not. It doesn't matter. And I think that's important for this group to understand.

It doesn't require new technologies. New technologies can be involved. It doesn't prevent them. It doesn't entrench anyone service provider, which I think is a concern here. I understand that. And all people can do this and shareholders do have that right. We support that.

As I said, we've been providing vote confirmation for over a decade. It's not that complicated. We do it. We'd be happy to continue doing it and we've demonstrated with industry pilot that people can do this and should do it.

BERTSCH: So ...

SHEEHAN: Ken ...

BERTSCH: Yeah.

SHEEHAN: ... and then Alex.

BERTSCH: So I agree with that. I think there are some things that could be done that are not that difficult that we should go ahead and do. Allison made the point about how important this is. I mean, this undergirds the whole system. So I think we should be doing the thinking about long-term solutions, as I said -- said earlier as well as addressing things we can do in the short-term.

As a fairly high priority, I would definitely prioritize it over a number of things like thinking about eliminating quarterly reporting, onerous regulation of proxy advisors that's intended to put them out of business. A -- a few other things that I think that Nancy should not waste his time with, but, you know, the -- the -- the transaction fee pilot that you're, I think, talking about over lunch, I think that's -- that's fair. There are a number of important issues that need to be addressed at once, I think so.

SHEEHAN: Alex?

LEBOW: I -- I think it's really very important and the reason why is -- is you have a generation of -- of new investors, young investors who are coming into their own and becoming larger investors. And they -- they don't participate in the system at all. And it's -- it -- long-term the risk is that their -- their faith in the capital markets is eroded. They don't feel like they're participating. There's an entire second half of investing. You know, there's the financial rights that are associated with equity ownership and the -- the governance rights, the voting rights. This whole half of investing is missing for a generation of people.

And I think over the long-term, what that means for society, what it means for -- for the country is -- is significant. So it's -- I think it's quite important it should be the top of the list.

SHEEHAN: Any of the other panelists?

ROCK: Can I jump in here?

SHEEHAN: Yeah, go ahead. Go ahead.

ROCK: So we called -- well, (inaudible) an article in 2008 "The Hanging Chads" of corporate voting, obviously, a reference to the 2000 presidential election. You know, the hanging chad ballot in Florida worked really well long time, and it didn't work one year. But, you know, who knows that there'd be another year that it didn't work. But the problem is that when it doesn't work, it's really awful. And voting played such a fundamental role in both the political context and the corporate context that if our technology is not up to what we needed to be up to, we need to fix it.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SHEEHAN: Thank you. Let's see, Damon?

SILVERS: So -- so I wanted to -- I wanted to pick up on a question that came up both in the last panel and in this panel. It's from -- from a number of different people in different ways, which has to do with the -- the -- the question of the desire of issuers to have access to the -- to direct access to beneficial holders. But before I do, I'm -- I'm just taken by what Ed just said, and I think it's worth noting in this conversation that the -- the -- the legal -- the legal foundations of the idea that this is a process that where -- where shareholders' suffrage and idea of one share, one vote very different than a political context with one person, one vote. The -- the -- the legal foundations of these concepts and what they have real bite is not here at the Commission and its rules, but rather in state law.

And -- and -- and so I think there's -- there's some irony in the notion that somehow the Commission is -- the Commission is -- I mean, the Commission has the authority to make sure the proxy solicitation processes is -- is not with fraud and is fair and accurate to everybody. That's the -- that's where there's been a -- a federal preemption. But going back to state law and going back to Delaware, and this area is actually going back to a tougher regime in relationship to the fundamental principles that a number of people have raised.

Now with that idea in mind and this sort of notion of sort of fundamental fairness, I want to come back to this question that -- of the -- of -- of direct access to beneficial holders because I think it's a conversation that's happened many, many times in the space. And -- and I want to note that at least it's the position of, I think, many institutional investors that Broadridge, in this respect, is a kind of -- is a kind of benevolent monopoly, meaning that it's obviously a monopoly. Broadridge may charge too much.

It's regulated by the SEC much as other types of monopolies. And Ken alluded to this before, natural monopolies are. But the key thing that Broadridge does is that it's a -- is that it's a -- a neutral arbiter of communication and has -- and has been that way in a fairly -- I mean, everybody is unhappy one moment or another, but that it's -- it's a fairly -- a fairly neutral party.

The promise of blockchain in this area, some people may be amused to -- to -- to hear that I -- I think this is quite possible. The promise of blockchain is that it could sort of substitute a neutral technology for a neutral -- for a neutral firm. But my question is -- so my question is this, for those people who have advocated that in some form or another through some technology or other that that registrants -- I mean, that issuers get direct access to beneficial holders, and -- and the argument that -- that -- that doing this through Broadridge somehow doesn't -- doesn't work.

What would -- what would your review be on how to ensure that shareholders got that -- that equal access to that list and -- and equal opportunity to communicate with -- with -- with beneficial holders in the -- in the world that -- that you would be advocating that -- that Commission moved to. And in this respect, I'm asking those. I know that Deborah said this. I think that -- that David may have said it. Those who are advocating for this notion that there be -- that issuers have direct access, how would you propose maintaining a level playing field?

DAMPEER: I mean, that level -- that level playing field essentially exist right now. I mean, as -- as the system is set-up and again this is at least for Delaware companies. If a company requests a list of NOBO holders and a shareholder under state statute, Delaware statute, requests shareholder records, the issuers obliged to turn that NOBO list over to the shareholder.

SILVERS: I'm -- I'm asking a different question, which is in the -- are you suggesting that -- are you suggesting that you think that the current system is biased against the issuer that the issuer can't communicate with that list?

DAMPEER: No, I'm not -- I'm not suggesting that the system is biased.

SILVERS: Right.

DAMPEER: I mean, what I am suggesting is that if the goal is to encourage more individual holders to vote, one of the ways that we think that can happen is to permit direct communication from an issuer or for a dissident in a proxy fight to ensure a level playing field that there's direct -- direct communication with them.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SILVERS: All right. So you'd be in favor of extending that. I'm not -- in some ways I'm not surprised that you are, but -- given your business model. But -- but ...

(LAUGHTER)

... but you'd be in favor of both sides having equal access to -- to beneficial holder list?

DAMPEER: Absolutely. I don't see how you can conduct what would be considered a fair election by having access to only -- giving only one side access to a significant group of shareholders.

FURMAN: What -- just clarifying for me at least, my understanding is -- is that you are right that, in fact, there is equal access to the list, but how up-to-date and how current that list is -- is within the control of the issuer.

DAMPEER: And whether or not they get a list in the first place.

FURMAN: Right. So if the issuer doesn't have a list or the list is outdated, the shareholder, the dissident -- there's nothing the dissident can do to say, Okay, can you update it to the list from two years ago is not really helpful.

DAMPEER: But -- but it's also something that at least certainly with respect to Delaware is a matter of state law.

(UNKNOWN): Right.

DAMPEER: Can I just make one comment on that please? It's not -- and I know there's the view of Broadridge sort of perhaps coming up the works in the middle. I just -- I also need to comment on the fees. The fees are the broker's fees. Broadridge doesn't have fees as they're not Broadridge fees whatever whether you think they're too high or too low, the fees -- regulated fees of the banks and brokers.

All shareholder proponents, management opposition can communicate with shareholders. What the current set of regulations prohibit is the disclosure of names and addresses and share positions, in some cases, particularly if you're a NOBO. So the current policy is that you do not have to disclose identity as a condition of share ownership. That's the current policy and hence you have this OBO/NOBO distinction.

That could certainly be changed and there are markets around the world where, in fact, as a condition of ownership you need to disclose identity. That could be a policy change. There certainly very strong views on both sides of that, but it could be accommodated.

That said, dissidents for a proponents or issuers can communicate freely with issuers. So -- I mean, I'm sorry, with their shareholders ...

(UNKNOWN): Right, yeah.

DAMPEER: ... to simply say distribute this material and the banks and brokers are obligated to onward -- work forward that information to their underlying clients and hold that security. And has been discussed, commonly is a subset of shareholders that are communicated with particularly in the contest. But the policy could be changed to require disclosure across the board and the strong views on that. We don't have a dog in that fight.

SILVERS: And, Lyell, this is the question I was asking, which I said, are those who -- are those on this panel who have been asking that the issuer be given access to the identities and whole and positions of beneficial holders, are they comfortable with that -- with -- with that information being made available to everyone with an interest in the election and in the vote or they're asking exclusively for themselves.

FURMAN: I, as a matter of state law, and this is what others were getting at, you could not restrict that to just the issuer. The question I would have is, I think, you would need to make sure that, you know, the SEC or some other agency had very strict limitations on what that information can be used for and had penalties for misuse of it.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SILVERS: I would add just on top of that. I think it was said before, there certainly would be -- we would need to consider -- you would need to consider how the underlying shareholder would feel about their information, name, address and position being made generally available. Even if the purposes of use were severely restricted, the fact that the information would be out in the public some place. It would be a significant concern, and that's a policy issue that I suggest would have to be dealt with.

ROPER: Anne, can I just jump in ...

SHEEHAN: Barb, yeah.

ROPER: ... really, really quickly, just quickly on your point, Damon. I mean, oh, you're absolutely right. We agree in fairness in -- in these.

The one thing though that I would say that goes to the point Lyell just made is in circumstances with registereds where -- where, you know, Trian could reach out and contact them directly, we did get flow back from that, right, with shareholders contacting us and saying, "What do you think you're doing giving my information out to them?" You know, my relationship is with you, not with anyone else.

And so I'm not saying that's governing, but I just say it to Lyell's point. There -- there are a bundle of issues here that -- that -- that -- that have to be addressed if in -- and I wouldn't argue otherwise.

SHEEHAN: Okay. We're good. All right. Mina and then J.W., and then I think Jennifer had her card up, yeah.

NGUYEN: Great. I have a point of clarification. I think, Lyell, you said vote confirmation is 100 percent available and that you've piloted this.

I think, David, you mentioned in your remarks that it is not available unless I missed that.

KATZ: I can't speak to whether the technology is available. I can tell you it's not used to -- I mean, people can't confirm that their votes have been counted. They can't -- you know, the example Brian gave a -- a significant fund that's been voting for 10 years and has an added shares counted. You know, somebody knew that, but it was never communicated back to the holder. And -- and the holder had no way of knowing, you know, that there was a way to find out because it has in the past.

I mean, I've had investors actually say, "Look, I've tried to confirm that my shares have been voted and all I know is that, you know, it's been -- it's going through the electronic system, but I don't know anything more than that. I don't know whether it was counted or not counted, et cetera."

BERTSCH: Yes, I would just say in addition to that, our -- our members do not feel like they actually have vote confirmation, in most cases. So setting aside a proxy contest and the -- and the inspector in that whole process where you don't have that.

It's only true if Broadridge is the tabulator. I'm -- I'm not sure how much of the market Broadridge has for tabulation, but the -- other -- other folks have not been cooperative for whatever reason. I'm not going to get between them, but it doesn't actually work in practice from the -- from a institutional investor standpoint.

DAMPEER: I would (inaudible) Ken just said. So we are -- both confirmation is available today full stop. It is not available in all cases full stop, and I think that's where the problem is. The opportunity to provide it in all cases, confirmation or not confirmation, is absolutely doable and possible today. And it should be encouraged or required, so we have been doing it. It does exist. It is not universally available.

NGUYEN: What percentage of the market do you have?

DAMPEER: A trick question.

(LAUGHTER)

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

We tabulate about 50 percent of U.S. meetings as the agent of the issuer, approximate 50 percent of the meetings. We provide a confirmation for our ProxyEdge users a proprietary platform that institutional investors use to manage their voting process, and they receive confirmation through the whole chain. We perceive their vote, we've accepted their vote. It's been voted in the final tabulation as instructed or not.

BERTSCH: Yeah. Oh, just to be clear, I think what Brian talked about where it goes into the inspector of large (inaudible) in the snake pit, you can't really confirm that.

DAMPEER: Well, because this contest is interesting and I think of P&G is a little bit different. Maybe I'll make a more general comment here. But in a contested election there is no tabulator. It ends up being that, in some sense, that two sides with their solicitors tabulate what they have, the cards that have been returned on their -- for their slate or their card. And the inspector's s job is then to match those off and determine whether or not a shareholder has voted on both sides, in which case, which is the last one that was in. That is a manual process.

That does not take place for street holders. That three holders, in their automated way, there's -- we went for the street positions. We tabulate in a contest. We are real-time determining if Lyell Dampeer voted, which card did he vote on? If he voted on multiple times or on multiple cards, what's the last one? We have a record. Every -- every single time Lyell voted, I mean, record of the last one and that's the one that gets aggregated.

We provide that information as -- on a daily basis to both sides. It's -- and the soldiers have that information. It ends up in the inspector to take the physical proxy cards, not the vote instruction forms distributed to beneficial holders. It's the retail holders that voted on proxy cards that have to be matched off. And that's where the problem comes up. And this -- this will sound perhaps self-serving or dangerous that -- because there's not a central processor in a case of a contest, you end up in this position where it cannot be resolved without significant manual intervention in the stories we've just heard today of weeks and weeks and 100,000 cards having to be physically matched off and missing paper clips.

If there were a central recordkeeping system, it could be a distributed ledger, it could be an entity like Broadridge or somebody else. In that case, you would not have that problem. You still have the challenge around looking at things like chain of custody and someone forgetting to change their name. That persists for 10 years because nobody goes back and tells the entity.

(UNKNOWN): Yeah.

DAMPEER: We don't see that you have voting rights. That's a tabulator obligation in our mind to go back and tell the entity. You don't have voting rights. Through the chain, you've never been given and issued an omnibus proxy in your favor for the shares that you hold.

KATZ: Wouldn't it be a simple SEC action to require that, you know, there'd be some type of transparency between the vote in the tabulations somehow?

SCHORR: I -- I think a number of us have said today it's -- something is wrong with the system where you cast your vote, you think it's being counted, and yet somehow along the process, without any fault of your own, that vote is either thrown out because of overvoting or undervoting or alternatively, it's thrown out because of some sort of other deficiency and no one comes back and says -- it gives you an opportunity to cure. I mean, most things, if something goes wrong, you get opportunity to cure especially for not voting the night before the election. But if you're voting a week or two before, as many people do, as many institutions do, you should have an opportunity to be able to fix something.

And someone should say, you know what, your vote didn't get counted, it got kicked out of the system. And a red light should go on. There should be a flag and -- and, you know, you go back and fix it.

SHEEHAN: Okay. So we've got -- I'm going to have to wrap-up. J.W., Jennifer, Heidi and then Jerry so.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

VERRET: Yeah, I just wanted to offer a -- a thought to kind of expand the discussion. We've talked a lot about blockchain technology with respect to tabulation, record-keeping and the promises there. And -- and that's an -- that's an exciting piece of that technology. But it -- we can think much **bigger** than that.

I -- I -- you know, I've had some fascinating discussions with folks **in** the Silicon Valley kind of world about using blockchain to -- to -- to change the nature of corporate governance **in** ways that will transcend our current understanding of corporate governance. And I think we can expect that's a -- that's a vision of the future not only **in** -- **in** ways that will make current technologies obsolete. Current -- current -- current large portions of the current infrastructure potentially obsolete.

I'm talking about things like on -- on one end of the spectrum, you know, public benefit corporations that use a different idea about stakeholder-based focus to more pure, you know, shareholder maximization systems that have a lot of deference. But, you know, the problem is you have these exciting discussions with innovators, with academics and then you sit down and talk to a securities lawyer and they say, "Yep, that violates (inaudible). It violates the Williams Act. It violates the listing requirements." Sorry, none of that is possible. Not -- not a single piece of that is possible.

And you look at something like I want to raise -- at the -- at the risk of raising the temperature here, I want to -- I want to throw out a crypto example, and I want to set aside the 33 Act Registration issues, set that aside. I mean, let's -- let's assume the law is right and let's assume you already have hard and fast views about 33 Act Registration.

There were some exciting things going on if you study the case of the Decentralized Autonomous Organization, the DAO, **in** corporate governance reform. They were facing problems, they were dealing with problems, they were figuring out new ways for members of that community to communicate with the centralized governance mechanism of that entity.

The SEC came down with a -- with a, you know, interpretation that that fund had violated 33 Act, and it's true and that's fine. But even when we get past that -- those registration issues, they're going to be all kinds of Williams Act issues, and -- and proxy solicitation issues and -- and disclosure issues. The SEC and the rules are not ready for and weren't made for. Despite the fact that I think, **in** the end, after some messy growth that can solve a lot of problems we're talking about **today**. So I hope -- I hope as part of -- of this, as part of the SEC's response to this, we'll get some -- some kind of at least a concept release about doing some **big** think about the future of -- of corporate governance and -- and how blockchain can not only change reporting and -- and tabulation, but also the nature of corporate governance itself.

There's flexibility **in** the underlying Delaware LLC law to -- to allow for this now, but there's not if we don't change listing requirements. Maybe that supported the discussion of bringing to venture exchanges or crowd funding reform, but also directly allowable we're talking about here Williams Act reform and proxy reform to facilitate blockchain innovation and governance. Our hope is going to be a part of this discussion where the SEC does similar work here. So I just throw all of that out there.

If you want to comment, that's great. If not, I just put **in** the record for something that I hope continues to be a part of the discussion.

SHEEHAN: Great. Any comments on that one?

BERTSCH: Just certainly, all of these things are related. And so, for example, there's been a fair amount of talk recently about time phase **voting**, we get extra **voting** rights or holding for a long period. We don't particularly like that idea, but it hasn't worked on a practical level **in** the past. And so if -- if you have a blockchain system or possibly some of the other systems, you can actually make it work **in** a way that's not onerous. So -- so I **agree** that these things are all related to each other.

SHEEHAN: Thanks. Jennifer, and then Heidi.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

MARIETTA-WESTBERG Thank you for your presentations today. I was formerly an economist at the commission, so (inaudible) the perspective of if the Commission chooses to engage in rulemaking, they will need to do economic analysis. And so I think it could be helpful to guide them in thinking about how to translate voting complexities or over (inaudible) economics. Some of the direct costs and benefits such as paper mailings are (inaudible) measure than the indirect costs of people not being able to vote or the (inaudible).

My question is do you think that the Commission has the data that they need to study this issue? Where would you suggest that they look (inaudible) relevant studies, et cetera that could be helpful?

DAMPEER: I'll make a comment just on some of the data, which certainly wouldn't have all the data, but we do have and have provided many times at the exchanges request data that looks at distribution channels, paper electronic platforms like Proxy Edge, also voting response rates by channel and how people do respond. You can receive something on paper and still vote electronically, for example, so there's a crossover there.

We'd be happy to continue to provide that information. We have information around costs associated with the actual postage for things that are physically mailed. We have that and can provide that. We -- there's other pieces of information we don't have. We do have a very large data set, which was -- we touched on something. It was mentioned earlier, but we would be happy to share that.

We have been instructed or asked to do that. We do it on behalf of our clients and we would be able to provide that data either as large file. It could be sorted different ways or in a structured way that would facilitate that from that perspective, so we could provide and we have provided some of that data before.

BERTSCH: I'll just say some of this is challenging for -- for Deborah and Brian. The benefit or cost of having Nelson Peltz on the board of P&G, I -- I think that's really hard and I suspect you have different views so.

(LAUGHTER)

(UNKNOWN): (Inaudible).

SCHORR: I'm not sure we have different views. Seriously, oh, obviously it's -- it's hard to quantify. But, you know, if you -- if you take -- if you take the view that having additional voices on the board -- of any board and diversity of views and -- and the ability to have robust conversations and discussions in a boardroom is a good thing. I mean, there's a positive. And how do you measure all that? I mean, you can look at different metrics whether it be TSR or EPS growth, you know, EBITDA, you know, whatever -- whatever metrics you want to use, stock price, and you decide which ones you think are important.

But at the end of the day, you know, you have to start with the assumption that having -- having another voice in the boardroom is important and -- and whether it's a dissident shareholder or whether it's a -- having board refreshment, which leads to new views and -- and new faces in the boardroom and new ideas, you know, if you -- if you buy into that theory, then that's all positive.

SHEEHAN: Thanks. Heidi and then Jerry.

STAM: Just quick comment. I mean, we've heard a lot today about opening up the market to greater competition, do ideas potentially disruption. I'd like to ask Alex if you could just tell us you've been in this business now for just a couple of years, are there barriers to either your firm or to other firms like yourself who would be looking to cause true change in this environment? And if so, are there of any that are particularly within the purview of the Commission to address?

LEBOW: Yeah, I'll just say it's -- it's not a healthy competitive market. We -- you know, there's a -- another thing we haven't mentioned, there's a price, you know, in this market, an artificially enforced price ceiling, which is an indication of a market that is not healthy. To run amok would -- would not be good for consumers.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

So yeah, there's -- there's -- there's a lot where we're competing. We feel pretty good about it, but, you know, there's -- there's quite a bit and I'll let go Ed Rock's comment about competition being one of the Commission's original mandates and the 33 Act. So yeah, there -- there is.

DAMPEER: Just to clarify, I think Alex' comment is an interesting comment. The fees -- just to clarify again, the fees are charged by the banks and brokers and saying Broadridge act as an agent under contract for banks and brokers. The NYSE with SEC proviso sets the maximum rate the brokers are going to be reimbursed by issuers for performing the services that are required to perform. So it -- the -- I think some of the consolidation overtime is a direct result of the fees having come down significantly over a long period of time for understandable reasons so we need to understand that. So it's not as though we're competing on price with the issuers when we compete with SAY. The issuer isn't involved in that discussion at all.

STAM: Right. And I -- I would suggest that this is an area that needs to be addressed because it is also broken. And I'm not sure that the investors getting the value from -- you know, for what it's costing in the overall system. So I would put that on the list of topics to be addressed and, you know, maybe NYSE is not the place for these rules to live.

DAMPEER: It did come -- the last -- the proxy fee advisory committee began work in 2011, I believe concluded their work in 2013 for fees that were changed under -- with their -- their direction approved by the SEC effective Jan. 1, 2014. It was recommended the fees be reviewed periodically, and we certainly support that.

STAM: Terrific. Thank you.

SHEEHAN: Right. Okay, Jerry, you get the last.

SOLOMON: Great. Thank you. Thanks to all the panels for coming because I learned a lot today.

(UNKNOWN): Yeah.

SOLOMON: It's not what I do on a daily basis. So, two things, one is I get my proxy email or I get my proxy card with the control number, and I put it in. And it says "Thank you. Your vote has been registered." Furious if that's really to say, well, it's sort of been registered and may not be actually a valid vote.

(LAUGHTER)

That's the first thing. And the second thing is this for you, Alex. You made a comment saying about mutual funds that they can't get shareholder votes. They should -- part of their fee should be held back. Where is that coming from? Am I understanding correctly why pick on mutual funds? Why not pick on corporations? And then -- or is it just another thing saying maybe mutual fund is a third party? Anybody who's using they should be looking at what third party they use to maximize voter participation. So there are two questions there.

LEBOW: Yeah, the -- so the point is that mutual -- it's -- it's actually in the interest of mutual funds. I think certainly - - certainly, the point is that fees are not going up, no new fees. Take a percentage of the current fee and have it only be collectible upon a vote -- receive of a vote, which is presumably what the fund wants, which require them to do what it needs to do.

And the -- the reason -- the reason for the suggestion is that it would incentivize the people producing the voter instruction forms who generally keep a -- a portion of the fees to actually encourage voting, just to get the system in line with encouraging voting. That's the -- because right now 100 percent of the fees are collected upon distribution and reference management and a few other complex things that have evolved over -- over the years.

We think -- if we talk about incentive fees, there was an incentive fee to incentivize paper, I would note, as an access. How about an incentive to -- incentive fee to incentivize voting?



## SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

DAMPEER: Just a quick comment and after I -- I understand the point. Today, it's the bank and broker that have the obligation to (inaudible) for the material and collect aggregate voting instructions because they have the -- the nominee has the voting rights by law. The beneficial owner has voting rights by contract normally, so why it would work.

And if -- if the bank or broker were required to do this and banks or brokers used to do this, so weren't people like Broadridge or SAY, if you go back in time, all the banks and brokers did this themselves. And if they were being reimbursed to perform the service based on the outcome, you know, you have to have banks and brokers in that conversation. They are currently the ones that are regulated and obligated to perform this, and the -- the fee is the maximum. They're allowed to charge for distribution, collection and handing off of the vote to the designated entity of the issuer. So I think that -- that would have to be brought into the conversation.

LEBOW: But I guess, to your point though is it -- just -- just thinking about it, we -- the mutual fund or anybody can't do anything unless they get the proper majority to do something. So if nothing is going to happen once they get the majority, which is the -- you want to maximize participation.

DAMPEER: Right, yeah. And I think, you know, you have to model it and think about what the specifics of it. I think fee -- total fees would go down under the system. It would be the idea because not 100 percent of people are voting. You'd have to get this since I think it would lower fees overall is what I have in mind.

(UNKNOWN): I still don't get it, but thank you.

SHEEHAN: Okay. I want to thank our panelists. We're running a little bit late for the Committee, but thank you. It was a great discussion and we look forward to continuing the discussion and seeing what can be done on the infrastructure. The goal of this, and I think for our Committee definitely is the proxy plumbing the infrastructure system itself. There are a lot of other issues that have been mentioned. Both the advisors as well as some of the other things, but I think trying to keep a focus right now on the infrastructure is very important because as someone said, we have been studying this. I think the concept release came out in 2010. This has been an issue that the events have overtaken and it's long overdue to have a look at this system. So, we appreciate your input and will follow up on as the committee moves forward on perhaps a recommendation in this area.

So, thank you all. The Committee were going upstairs for lunch, and then we will reconvene as a Committee at 1:30 back into public session. Thanks.

(RECESS)

SHEEHAN: I'm going to call the Investor Advisory Committee back into order. And we have Commissioner Jackson with us to make some comments.

Anyway, while our members are sort of filtering back in, but nice to see you, Commissioner Jackson. We missed you this morning. Want to say a few things (inaudible)?

JACKSON: Sure. Well ...

SHEEHAN: They'd love to hear from you.

JACKSON: Thanks so much. I'm delighted to be here. And, well, folks, circle back in, I wanted to start by saying how much I appreciate all your work on the issues you're considering today and the questions you discussed this morning, the voting system for corporate elections and how best to ensure that American investors can hold corporate management accountable, these are crucial questions to the future of our markets. And I'm delighted to be here with you.

Let me start by joining my colleagues, and I wasn't here this morning so I really want to make sure I say how delighted I am to welcome our newest Commissioner Elad Roisman to our team here at the SEC. You know, I first met Elad in his capacity at the Senate Banking Committee during my own nomination and confirmation process.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

And I discovered what really everybody in Washington already knows, which is he has earned a reputation as a fair, thoughtful public servant who puts investors at the forefront of all that he does. I'm truly delighted to have the opportunity to work with Elad and his expertise, judgment, and really most of all, his commitment to our mission will serve investors well.

As I say I'm am pleased that the IAC is considering how the voting system can be improved to make sure that American investors finally get a better say in how the companies they own are run, and that work is made all the more important by today's announcements from the Office of the Chairman and the Division of Investment Management, which suddenly raised questions about long resolved issues in this area.

Because the IAC's important work in this area is ongoing, it's important to clarify the path ahead for those of us interested in giving American shareholders real access to the levers of corporate democracy. It's time to get something done in this area rather than dedicate the staff's time to politically contentious questions about regulating the few firms who advise shareholders how to vote.

The first thing I want to say today is that the law of proxy advisors is no different today than it was yesterday. The Commission has long recognized their proxy advisors, the companies that develop recommendations regarding how investors should vote on corporate questions that they serve an important role in the shareholder voting process. And today's statements do nothing to change that.

Our staff stands as ready today as they ever have to give investors guidance regarding their use of proxy advisory firms. And investors themselves who have long taken different approaches to how they handle that advice should rest assure that the Commission remains committed to giving shareholders a voice at American companies.

Second, there is broad agreement about the issues you all discussed this morning. The Byzantine system that makes it impossible to know whether shareholder votes are counted must be fixed. Over the last decade, while our voting technology has made enormous leaps forward, ordinary American investor participation in corporate elections has declined.

Today, less than one in three investors has their vote counted in corporate elections. Now we at Commission have known this for years. We issued a deeply thoughtful concept release on the subject in 2010, and it's time to act. American investors shouldn't have to wait any longer for their votes to be counted in corporate elections. That's why I'm delighted that the Chairman has announced roundtables on the subject to be conducted later this year. But I'm troubled that rather than focusing on getting the -- the voting system fixed, making sure that every American investor has a chance to participate in corporate elections, the roundtable in today's announcements emphasize contentious issues regarding the regulation of proxy advisors.

(Inaudible) proxy advisors has long been a top priority for corporate lobbyists who claim that these advisors have too much power in corporate elections. There is, of course, little proof of that proposition and the empirical work that's been done in the area for the better part of the decade makes clear that the claim is vastly overstated, which is why moving too quickly in this direction have little basis in the evidence.

More generally, it's hard to imagine that upon a survey of all the problems that plague corporate America today, the Commission should conclude that investors getting too much advice is one that deserves our immediate attention. In fact, the lack of competition among proxy advisory firms is itself reason for pause. As regulation in the area risks further deepening the moat around the incumbents that we have, empowering the very firms that somewhere we already have too much influence.

Look, whatever one thinks of these questions might plea to my colleagues and to this committee is to not allow corporate lobbyist priorities to sidetrack our important work in fixing the American system for corporate voting. We all know too well that the entrenched interest in this area can delay the repairs to the voting system, which is why in the eight years since the staff issued this incredibly thoughtful concept release, the system is virtually unchanged.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Almost all market participants agree that that system is broken, a fact that experts around the table today saw and start relief when few even large shareholders could tell whether their votes were counted in a crucial corporate election. The only question is whether we, at the Commission, can focus on that problem and solve it without being sidetracked by politics.

That's why I'm so pleased that today the committee has focused its attention strictly on the voting system and how we can and should be fixed in a fashion that'll make sure that every American investor has their vote counted in corporate elections. I hope that the Commission, too, will focus on our obligation to all investors to get that system fixed.

Thank you all for the important insights you've offered today. I so look forward to your recommendations and to helping give American investors the corporate voting system they deserve. Thanks again to all of you for your time, and I look forward to the conversation.

SHEEHAN: Thanks. Thank you, Commissioner Jackson.

So, continuing on our agenda, the next item is the discussion of the recommendation regarding the Commission's proposed transaction fee pilot in NMS stocks.

Matt, your subcommittee had done some work. We all have a draft letter. I think it's been posted for comment. I know we've received a lot of comments from folks on the -- on the recommendation.

Is Paul Mahoney on the phone?

MAHONEY: I am here on the (inaudible). Can you hear me?

SHEEHAN: We can hear you, yes. So, Paul was kind enough to be the -- was the first one who put pen to paper on this recommendation, so he's been kind enough to say he will share a little bit of the background on this and then we can open it up to questions and comments from the Committee members on the recommendation.

Go ahead, Paul.

MAHONEY: Sure. So what we start with the (inaudible) the pack that for a long time exchanges impose a fee on each transactions, and that might have been in the range of five mills, meaning five 100 (inaudible) and more recently exchanges have moved to a so-called maker-taker pricing, which I think is best illustrated by a simple example.

Let's imagine that a particular stock at a particular moment in time of national (inaudible) offer \$10 bids. \$10, of course, is offered. Customer A comes to Broker A and says, "I'd like to buy 2,000 shares, but I'm not in a big hurry and so I'd like to see if I can do better than \$10.04. Why don't we put in a limit order for me to buy \$2,000 shares at \$10.02?" So the broker takes that order and post it at Exchange A.

I want to make three observations about that. First, Broker A has quite a bit of discretion about which then you would take that order to. Second observation is in my hypothetical, there's no seller at that point that's willing to sell at \$10.02, so that order does not execute immediately. It's what we call a resting limit order.

Final observation, if something else happens, that \$10.02 now becomes the national bid that improves over the previous \$10 bid, so that narrows the spread \$0.04 to \$0.02. And in that sense it adds liquidity to the market because the spread is one dimension of liquidity.

Now, let's assume that Customer B comes along and tells its broker -- Broker B, "I want to sell 1,000 shares immediately with available price," so Broker B takes that order to the exchange and execute (inaudible) A that's the limit order. Again, a couple of observations. Broker B has less this fraction with that order because in my hypothetical this \$10.02 limit order is the best available price, and so the broker, under the order of protection rule has to go towards changing.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

And the second observation is that by removing 1,000 shares of demand at \$10.02 that market order has reduced the market down and in that sense has taken liquidity some step as another dimension of liquidity.

Now, understanding the maker-taker pricing, Broker B, the one who represented the market order will pay 30 mils of which 25 would be rebated to Broker A, the Broker B osted the (inaudible) against which that order executed.

Here, another observation, if both customers A and B are retail customers, their votes probably have some (inaudible) schedule, say the customer paid \$5 a tray. And that means that Broker B is going to pay the 30 mil access fee out of his Commission revenue, and Broker A is going to add the 25 mils to her commission revenue. So that sounds the fee structure is visible to the customer. It's s really the broker that -- that pays or receives the fee.

And the question (inaudible) of the pilot is how does this pricing structure (inaudible) broker (inaudible). Now, in simply hypothetical, there's s no issue at all because A's s limit order is the only order to buy at \$10.02. The next best bid is \$10, so the next market order necessarily goes to Exchange A where that \$10.02 bid is posted.

But in the more typical case, let's s imagine that we've got other customers who are coming in with limit orders at the same price. And to further complicate matters let's s imagine we've got an exchange with maker-taker pricing that already has a bid \$10.02 at another exchange the traditional pricing that is to say just the five mil transaction. Well, after Broker A enters a limit order for Customer A, and now another customer -- we'll call Customer C -- comes along and wants the (inaudible) limit order of \$10.02, it would clearly be in that customer's s best interest to go to the traditional pricing exchange because if it goes to Exchange A, it ends up being second in line behind the existing limit order (inaudible) different (inaudible) it goes first in line, moreover because that exchange has traditional pricing but the extra limit order (inaudible) market order, excuse me, is going to go to that exchange in order to avoid paying the take fee. But that's s not what's s best for the broker. What's s best for the broker is to go to the maker-taker exchange when there's s the possibility of capturing the make fee.

So the question is what if the broker tells the customer, I'm going to take you to the maker-taker exchange, a lot of you bump up your price by a cent and that gets you to the front of the line. That's s a direct conflict between the broker's s interest and the customer's s interest. And the question is did that actually manifest itself and how often did the bank (inaudible) itself? Are we really seeing the others are routing orders to capture the fees rather than based on what's s best for the customer. And that's s really what the pilot is all about. It's s designed to gather information about (inaudible) based on different pricing structures.

The market structures (inaudible) believe that it would be extremely useful to get data on -- on -- on that issue and their -- and -- and that then would help the Commission decide whether it should regulate access fees in a different way from its current regulation, which simply caps the access fee and doesn't say anything about rebates.

SHEEHAN: So, let's -- why don't we open it up for discussion? I think most of you, J.W., have seen and have commented on the recommendation to see, but I think the idea is to sort of put it into a little bit of context as to where this came from and why we feel that this would be a good thing for the committee to make a recommendation on.

So, J.W.?

VERRET: Yeah. I -- I support the letter and -- and -- and appreciate Paul's s work in drafting the letter and was generally supportive of the various tweaks suggested along the way, so happy to go along with the will of the group on that. And for my part, commend the Commission for its deliberative approach here. And I offered a separate comment letter to the rulemaking regarding assertions made by a couple of large exchanges who have implicitly threatened to sue the Commission if it goes forward with the pilot. And I have offered my own perspective on business roundtable versus SEC and the Chamber versus SEC and how those arguments would play out. I anticipate they would lose.

I just want to note that part of the reason why they would lose under the ruling of Chamber versus SEC is that one of things courts look into when they review rulemaking is deliberative process. And the fact that we got a

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

recommendation from the MSAC, the fact that we've got a -- a open comment period on a -- what will be a pilot and that will involve subsequent possibly rulemaking relative -- related to the pilot. And effective now if we got up recommendation from the IAC, there'll be a long list of things. They want precedent cases like the Chamber versus SEC. So in any event, today's suggested letter is -- would be relevant to a subsequent litigation if we go there. So I want to note that, and it's another important benefit of what we're doing today.

SHEEHAN: Perfect, terrific. Lydia?

MASHBURN: I also want to thank Paul for his work in drafting this and all the other members of the Market Structure Subcommittee. I have to admit I actually (inaudible) there are areas of the letter that I would not necessarily be able to support. I think the goals of the pilot are really laudable, trying to do rulemakings with data and information.

I'm not sure that the pilot is the best way of going about collecting that data. That data technically already exists. It's just hard to get to. I am not sure that putting 3,000 companies into a test experiment is the best way of trying to figure out if the rebates are really affecting order routing. And I also think you're going to end up with a set of data that is not complete because you are not capturing a full set of areas where workers are routing their orders. And, of course, you're referring to alternative trading systems or other dark pools.

So I -- I -- I laud the goals of the Commission trying to put forward this pilot and the idea of trying to have databased rules and regulations. I think that we should always look at where our sources of data that already exists before we start basically playing around with a bunch of companies that have, you know, whole payrolls to fill in people's actual livelihood is kind of on the line in the long run. So I feel like we should just be very cautious before we make an experiment of 3,000 companies.

I also think that there -- there are challenges that the rebate problem is a -- it's a symptom of a larger problem related to Regulation NMS. And I think that going in the direction of trying to solve this one tiny tree problem when we have a forest problem and subjecting so many people to -- so many firms to what really does look like an experiment for -- for reasons that you're not even going to get full data from is just, in my -- my view, not the best way of going about it.

But again, I agree with the goals of data-driven regulation. I agree with the -- that there is a problem with the way some of the rebate structure is affecting markets and might even be affecting order routing and all of the other issues that Paul referred to. I just don't know if this is the best way of going about finding out exactly what the problem is and giving us the most accurate information to make the best rules and regulations off of so it's where I would stand on that.

SHEEHAN: (Inaudible)?

SILVERS: I wonder -- would you -- would you be able to explain a little bit more your comment about the -- that there's something more systematic wrong with NMS?

MASHBURN: The -- my understanding of it, which I will admit that my -- my field of expertise is not securities markets. My field of expertise is monetary policy, but I like to look at systems as a whole. And we'll -- in my field of work we're always looking at where are the root problems.

In my admittedly limited understanding of the situation, Reg NMS has put on a number of restrictions related to order routing and best execution and forgetting what is it four, five different ones. And in combination, looking at the way they interact with one another, it has created some perverse incentives in the way in which orders are executed. And so I think that we should be looking holistically at the marketplace and trying -- and I know the Commission is doing work on broader issues related to Reg NMS.

So, to me, it's -- you should be looking at how these things are interacting, what are the incentives that are being created and sowed in my mind. It's that loose combination of rules and restrictions from Reg NMS that cause this --

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

part of it is the best execution, issue pushes orders into certain marketplaces, which then means that they could charge astronomical fees so then we put a cap on the fees so that they can exploit the fact that that's the order of best execution. And then we -- in order to make up for some of those costs, then the exchanges are competing by trying to rebate to brokers and incentivize them to use their exchange.

And so you've created this whole domino effect of problems and challenges. And we're looking -- I think with this pilot, we're looking at one little tiny bush, and in reality it's the whole -- the whole force we need to be looking at because they're all interacting with one another. So that's what I mean. And I apologize that that's not ...

SILVERS: No.

MASHBURN: ... as expert as it should be, but ...

(LAUGHTER)

... that's my limited understanding at the moment.

SILVERS: I was -- I was going to say I suspect if you went around this table, you -- you'll be right in the top 10 percent of understanding.

(LAUGHTER)

I would just -- I just observed something. I have said on this -- on this Committee many times that I think that an aftermath of Reg NMS that this fundamental problem is in terms of the fairness -- in terms of the fairness of the way that trading markets are structured and who has access to preferential execution and -- and -- and that -- that really -- that really undercuts sort of the fundamental Commission missions.

I looked at this proposal and it seemed to me like, hey, it's a start, right, at trying to unpack some of that stuff. I would be supportive of a more comprehensive approach. I'm not really supportive of doing nothing. And -- and I would look to -- again, you know, to other people who understand better what -- you know, what would be involved in a more comprehensive approach.

But I feel like, in this area, there's been so little action in response to such egregious problems that I'm really reluctant to -- that -- that as a body, we -- we not endorse even partial solutions if they are -- you know, if they -- they get -- if we get past the do no harm kind of -- kind of -- kind of principle, right?

MASHBURN: (Inaudible).

SILVERS: Right.

SHEEHAN: Yeah. And the one thing and I know we've got a couple other questions in response, I -- and I think when you brought the issue up on one of the calls and we added some language about asking the Commission, you know, that Reg MNS -- NMS was adopted more than a decade ago and it'd be useful for them to look at sort of the bigger issue because I think when that discussion was brought up on the telephone, everybody agreed. You know, as Damon said, it's time to take a look at this.

So we did add the language, I think, in response to your issue that we don't want to take it out of context kind of building on, you know, some of the other comments, I -- there's people who've known me, I have an adage, perfect is the enemy of good. You know, it isn't ideal, but we're moving the ball forward. This will give them good data. You know, I know people have views about pilot projects, but, you know, we're responding to what they had done and we'd like to encourage them to move forward on this. And as we have also done, encourage them to move forward on the review of NMS.

So, I have got John, Jennifer, Mina and then I don't know if J.W. has another. Okay. So, John Coates?

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

COATES: Yeah, real quick. So, since this was distributed, I was asked why am I against the order of protection rule. And I said, what are you talking about? And apparently this is being read as an attack on the order of protection rule, which is an interesting feature of our fishbowl life.

So I -- so I -- I want to both embrace, Lydia, your suggestion and -- which is, I think, was intended to be reflected in this paragraph and -- and also maybe address the -- the reading of this as -- as critical of the order of protection rule by making a friendly amendment suggestion to the language, which would just be to say more simply it would be useful to conduct a broader study of the effects of Regulation NMS as -- you know, as well as pursue the pilot. And that then takes out the bit about unanticipated not in the best interest and linking it to the order of protection rule. So I'm happy to reread that, so delete everything in the -- in the second sentence -- in the third sentence and replace it with, "It would be useful to conduct a broader study of the effects of Regulation NMS in addition to the pilot."

And I think it conveys the same intended semantic meaning and remove some of the suggested prejudgment because although Damon may be right that -- and -- and Lydia may be right that there are perverse things going on. I -- I haven't engaged that yet, and so I would rather have it be more neutral if we could do that.

Do you mind? (Inaudible) is the official author of this, yeah.

SHEEHAN: I think that's Mr. Furman's subcommittee.

COATES: Okay.

FURMAN: Yeah.

COATES: (Inaudible), Matt.

FURMAN: It sounds reasonable. I ...

COATES: Great.

FURMAN: ... Paul with the pen has the final call on that.

COATES: Okay. So, Paul, you're on.

MAHONEY: Yeah, that's fine.

COATES: Right.

MAHONEY: Yes, I mean, the -- and then certainly the (inaudible) prejudge the issue.

COATES: Right. Great. So I think -- yeah.

FURMAN: Yeah.

COATES: And if you didn't get those exact words I'll give them to you after. Great.

SHEEHAN: Okay. Jennifer, Mina and then J.W.

MARIETTA-WESTBERG I just want to say that there has been some recent discussion in the public press about the potential cost that could be significant of pilots in general. So I would be in favor of the most parsimonious model, most parsimonious methodology that the Commission can put forward on this pilot that would still allow the results to be broadly applicable and allow them the statistical confidence that they need.

SHEEHAN: Mina?

NGUYEN: I know you want to move on, so I just wanted to make a -- the same comment. There is, I think, kind of burdensome responsibility on these pilot tests. I think it does wear on the companies and whether or not both the

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

CFTC, SEC and others are looking holistically at some of these fundamental challenges in market structure and whether or not there's a way to prioritize what data we're looking for and how many pilots they like to run to test the ecosystem would be a little (inaudible), and people could then understand and prepare for it rather than, you know, announcing these pilot haphazardly, it feels.

SHEEHAN: And then J.W., did you have -- John, do you -- Okay.

COATES: I'm good, thank you.

VERRET: Yeah, just to -- just to share a little bit of my sort of evolution in thinking in market structure why I support the pilot because, I guess, I probably say no more often than I say yes and -- and probably will in these meetings, but I -- I view this -- this area as having a great deal of analogy to -- to government-sponsored enterprises in the housing sector and to credit rating agencies in their own sector. And by that I mean, there is a great deal of concentration, and that concentration is not a result of natural market forces, it's a result of government intervention and government regulation, and certainly going back all the way to certainly you can (inaudible) parts of the '75 Act amendments in -- insofar as they made choices about where property rights and trading information rested that were not a result of natural market forces, but sort of just the fiat of the statute saying the -- the property right rests here with exchange and Reg NMS and -- to the consequence as post NMS.

And so I -- you know, I -- I think I view the -- the pilot as addressing issues of market concentration created by the large exchanges in their relationship with the Commission and -- and barriers to entry and other regulatory just -- just -- just the fact that this -- their business models are so enmeshed in -- in regulation.

I think that the -- the claims of a few issuers about effect on spreads are just not -- I -- I don't find them particularly compelling because in part first, you know, the -- the -- we didn't hear issuers complaining particularly this group of issuers complaining about tick-sized pilot, which directly change spreads. And so their Johnny-come-lately concerns about spreads, I think, are a result of communications we've have seen from the large exchanges to a few issuers using their market power to encourage issuers to do a couple of last-minute letters into the pilot.

I just don't find those arguments particularly convincing. And I would also say that those pilot, I don't know where this is going to go and whether I'm going to agree with the Commission. And I don't know there's a whole range of different possibilities where this could be a post pilot. And I know one that a lot of people discussed this pairing the idea of a -- of a -- of regulation rebates with changes or complete rescission of the order of protection rule, pairing those things together as a way to find a good policy and find bipartisan consensus on the Commission.

Will it work? I don't know. I'm not even I agree with them or not, but just to suggest there's a whole range of outcomes that could happen post pilot. So, supporting the pilot doesn't -- I hope it doesn't mean being wedded to what comes after it. So this is a very small modest step and I support it in that respect.

And the other thing, too, I would put in a plug next Wednesday 10 a.m., Commissioner Jackson is going to come and give speech at Scalia Law School. And then after there's going to be a debate between me and Ty Gellach from Healthy Markets. You all should all come because this is part two of the discussion we have today. So come to Scalia Wednesday 10 o'clock or tune in. Listen to Commissioner Jackson who's never shy or Ty or I either in discussing all of these issues. So thank you for putting up with me.

SHEEHAN: Well, if -- if that's going to be webcast or whatever ...

MAHONEY: Anne?

VERRET: Yes?

SHEEHAN: ... that would be great.

MAHONEY: Anne, could I -- could -- could I make one (inaudible)?



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

SHEEHAN: Absolutely. Go ahead, Paul.

MAHONEY: So, I -- I just want to -- to make a quick point that we have data at the moment about how orders are being routed on that system in which we cap the access fee. But that's s it, we cap the access fee. And what the pilot would (inaudible) is what happens if we say rather than they're being just a cap, no rebates. And, you know, I think that's s are actually an important new piece of information that we would learn.

SHEEHAN: Yeah, good point. So, Matt Furman and then we're going to entertain a motion because we knew -- oh, Damon has a -- Okay, so Matt and Damon.

FURMAN: To, Paul, if you can maybe just briefly explain why if you're an issuer you -- in your view you shouldn't be very concerned about being in one of the -- the test groups versus the control group because I -- I do know this is something that, you know, was raised you thought about before you -- you put in the letter. And I know it's s been -- been raised more generally.

MAHONEY: Sure. The -- the argument that some (inaudible) have made is that if you're in a group -- if you're in one of the buckets with a lower fee cap, then your stock may be less liquid because what's s going to happen is they -- marketmakers are going to be less interested in quoting that stock because they don't pick up the -- the make fee.

But I think that (inaudible) is that (inaudible) provided at some price, and whether you -- and the way you split that price between the nominal spread and access fee or rebate is not as important as the net number. And that net number is going to be set by the market. So I don't really agree with the view that somehow there is going to be a -- a dramatic change in -- in realized liquidity for companies that are in one bucket versus another.

SILVERS: So under -- what's s flying underneath? Let me explain what I mean. My concern about Reg NMS is that Reg NMS offered a particular solution to the question of -- of sort of preferential treatment in the securities markets, which is the order of flow rules.

I'm not at all -- I have -- do not have the expertise of some of -- of -- of our colleagues here on this, but I'm not at all convinced by what I've seen over the last 10 years that this has been at all an effective way of achieving that goal. That goal of -- of -- of fair and equitable treatment of -- of securities markets participants who do not have billions of dollars to play with is the core -- is the core reason why this Commission exists. It's s why the Securities Act of '33 was written and -- and the '34 Act, which is absolutely more relevant to this. Why -- why these acts are written and why this agency exists?

In that respect, if the -- the existence of this agency is premised on the notion that there's s no such thing as a natural market order, that the existence of -- of corporations, the publicly-traded corporations of securities markets, all these things are the product of the interaction of economics and -- and policymaking. And the question is not whether or not we're seeking natural orders here, but whether or not we are effectively ensuring that suit -- that -- that our markets are fair and equitable to all participants and particularly towards smaller investors, which is after all what the pre- what it was -- what it was demonstrably true, the pre SEC securities markets were not.

With that in mind, I come around to -- to -- to believing that as long -- that with John's s additions, this proposal is -- you know, is a good effort to try -- to try to get at these goals. You know, J.W. and I may not agree about -- on -- on sort of legal philosophy, but I think we're both open to the notion that we ought to do something here because what we have in place is not really working in -- in -- in the -- in the manner that sort of fair-minded investor advocates would like it to work.

And so -- so that -- so that leaves, that -- that -- I wanted to explain sort of where I come from here. I definitely am not in favor of the notion that we ought to let these markets that the Commission ought to withdraw from trying to protect small investors in these markets. I think that would be a terrible idea. And -- and -- and so anyone who wants to read, you know, my -- you know, sort of -- sort of somewhat hedge support for this proposal as an attack on -- on the order rules, understand that's s not -- that's s not my intention, but my intent. But -- but it's s clear that what

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

we've got right now in total is not -- is not producing, in my view, the -- the -- the type of fair and equitable market it was intended to produce.

And that's a big problem, and this is a small step in trying to do -- in trying to, you know, address an aspect of it. That seems to me like, you know, what we ought to be supporting.

(LAUGHTER)

Yes, I guess, suppose it is.

SHEEHAN: Right. All right. So I don't want to cut off, but I think everybody who wanted to give 30 seconds.

(UNKNOWN): Just that we have a lot of data, but we don't have much data about the really important question that the impact of rebates on best execution and FINRA D.C. I heard them say it best trying to -- right now trying to enforce best execution like trying to nail -- nail Jell-O to a wall, so this solidifies it turns at least into pudding perhaps, but that's s the key (inaudible).

SHEEHAN: Okay. So without any further ado, then I will call the question. We have a motion and second to approve the recommendation from the Subcommittee with the John Coates amendment, which we will circulate around the wording to him.

So, all those in favor say aye.

GROUP: Aye.

SHEEHAN: Any opposed?

(UNKNOWN): Aye.

(UNKNOWN): Aye.

SHEEHAN: Any abstentions?

(UNKNOWN): I'm going to abstain from this one.

SHEEHAN: Okay. Yeah, the phone votes were -- was it Barbara and Elisse? Is that correct?

(UNKNOWN): And Paul.

SHEEHAN: And Paul.

MAHONEY: Assuming an aye also.

(UNKNOWN): And Stephen.

MAHONEY: And Stephen is (inaudible) though.

SHEEHAN: Oh, Stephen, Okay. All right, very good. So for the minutes, we're going to have that reflected. Great. Well, thank you all. Thanks for the discussion.

Matt, thank to you Subcommittee.

And, Paul, especially thank you for all the hard work on this because I know we sort of grouped you into action very quickly on this. So, very nice job and we look forward to -- we look forward to seeing what happens with the pilot project and hopefully move forward quickly.

Okay. The afternoon session is going to be facilitated by my colleague, John Coates.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

COATES: Great.

SHEEHAN: So, John, why don't I turn it over to you to introduce our guests? I apologize for being a little delayed on that. Certainly, you can give us reviews on Reg NMS if you want to add it to -- your thoughts on passive investing.

COATES: Right. Thank you. And I am mindful of time and so I'm going to keep my introductory remarks to essentially introduction other than to say that I'm delighted that our panelists have been willing to participate because I do think the increase of passive investing overall is one of two or three of the most important overall trends affecting the context in which the SEC has to function and in which the rules that it passes and implements are -- are being affected enormously and lots of ways that we don't know yet. And so this is very much viewed as an early-stage informational panel and not one that's geared at any particular policy outcome.

I've been thinking about it long enough to know that I really don't have any great ideas. Otherwise, I have already presented them. So, I'm hoping to learn from you guys.

So, to that -- to that end, let me -- we're going to start with Jeb Doggett who's a managing director at Casey Quirk, which is -- is it of Deloitte, by Deloitte, with Deloitte? By Deloitte, what does that mean?

DOGGETT: (Inaudible).

COATES: Okay, you're independent, got it. Okay. Thank you. Take this away. There's a little light over there that will warn you when you're getting near the end of your time. Here we go.

DOGGETT: Okay. So thank you for having us here. I think that passive investing is probably one of the most significant trends going on in asset management today. It's disrupting the -- the overall asset management business and changing the way millions invest.

And while it has grown very dramatically, we believe the significant growth is likely to continue for a number of reasons, which I'll talk about. So I wanted to kind of set the stage for the panel that -- and -- and provide some perspective on the size of passive investing, the source of growth, market demand, and then provide a forecast of where we see the market, you know, out five years.

So today, when we look at the global passively managed assets, they have grown to about \$15.6 trillion, and that's -- that's -- they've grown at a compounded annual growth rate of about 20 percent. And they have grown at about two and a half times the growth rate of what I'll call traditional active investments. So, passive today now represents 23 percent of the globally professionally managed assets up from about 15 percent five years ago, so tremendous growth.

When we look at sort of net new money coming into the -- the market, which we would call organic growth -- growth or net new flow, over the last three years, 50 percent of the -- of that organic growth has gone into passive strategies. So, it's really the dominant sort of choice in the -- in the business -- in the business today.

If we just focus on the U.S. for a moment, the world's largest market passive strategies have grown to \$11 trillion and represent 31 percent of the professionally managed assets. This is significantly above other global market, so the number in Europe is about 19 percent. In Asia ex-Japan, it's only about five percent. Japan is a special case where passive investing is really dominated by the GPIF and the Bank of Japan. And over 50 percent of the assets in that market are -- are managed passively.

So, what are the sources of this growth? You know, it starts out by looking at what's been going on with institutional investors in the pension market. So they started investing passively, you know, 20 years ago and grew their allocations in passive investing to about 25 percent. And -- and that number, that level of passive investing essentially plateaued there.

Then we have the defined contribution system, which is dominated by the system in the U.S. And what we saw there was -- what we see there is more and more because of the simplicity, and the low fees, and the desire by plan

## SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

sponsors to have a kind of a low-risk solution sort of not taking manager's election risk, the adoption of, you know, providing passive options came to dominate the landscape. And then when we had the -- the target date funds coming in as the default option, on many of them are driven purely by passive underlying investments. And those that aren't, it's interesting a number of leading firms are now -- are now offering hybrids where they have some passive and some active products within their -- their target date funds. So that continues to be a major source of new money going into passive investing.

The next big development was the creation and launch of ETFs. And today, ETFs have become a \$5 trillion market, and they now represent the majority of passive assets in the U.S. And when we look at the organic growth rate and net flows over the last three years, two-thirds of the money has gone into the ETF vehicle. So a major -- a major innovation in a major disruptor.

Some of the reasons for the broad adoption have been kind of the tax benefits of ETFs, as well as access to new asset classes, like gold or real estate where individual investors really couldn't get access to those kind of betas or market exposures in the past. So, I left off the biggest segment of passive investors, which is individuals -- individual asset on behalf of individuals. They have invested over \$7 trillion in asset passive strategies representing 30 -- 38 percent of their overall portfolio.

What are the reasons for that? Well, I think there are three. First of all is performance. Over the last one, three, five years you can -- you can pick. Active strategies has -- have a -- have a -- as a group, have generally outperformed passive. And you can -- you can look at, you know, multiple time frames, different asset classes, but the vast majority of active managers have underperformed.

The second big theme is fees. Fees have risen an importance to the gatekeeper, so the big intermediaries of financial advisors, even the institutional gatekeepers are putting more emphasis in their screening and selection process on the area of fees. And so while we're seeing fees in general across the industry declining, they're declining fastest in the passive sector across passive strategies as -- as their providers really take advantage of scale, and -- and continue to lower the fees.

And then the third driver is what I would call solutions where investors have really -- after the financial crisis have refocused on thinking about their portfolios in the context of the objectives they're trying to achieve as opposed to simply filling a stylebox and trying to beat a -- a specific benchmark. And in that context, more investment advisors are taking on the role of truly advising their clients in building, you know, holistic portfolios and their value-added is shifting to be more aligned with the asset allocation.

And as result, they are using less expensive, in some cases, you know, generic exposures as building blocks, i.e., passive -- passive building blocks, whether that's a fund or an ETF. So, for those reasons, you know, we've seen massive growth of passive within the indictment marketplace.

Looking forward, you know, where do we see continued demand? Well, the first is the intermediaries that I spoke about, you know, there's a whole generation of financial advisors that, as a business practice, use ETFs as the primary vehicle and -- you know, and they're not going away. Secondly, when we look, as I mentioned outside the U.S., individual investors still have a significantly lower level of passive exposure, and so we believe over time in part due to regulation like RDR and MIFID II in -- in the U.K. and Europe, they will begin to use more passive investing. We continue to see the upward trend in allocation to passive among defined contribution plans. And then finally, we see a lot of innovation in the passive arena like alternative-weighted indices and fundamental indexing.

So, just one last point, which is when we look out across the horizon over the next, you know, five years, we think that the -- the share of passive investing will grow from 30 percent today to 35 percent of the professionally managed assets. And that would be a -- a passive market greater than \$25 trillion.

COATES: Right. Thank you very much for that overview. Next, we have Rodney Comegys. Am I getting that close? Rodney ...

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

COMEGYS: Comegys.

COATES: Comegys, thank you, who has been the -- a Principal and Head of Risk Management at Vanguard but was just recently appointed Head of Equity Index Investing, so the perfect person to comment from industry's perspective.

COMEGYS: Thank you to Chairwoman Sheehan. Thank you to Professor Coates for chairing the panel and to the whole Investor Advisory Committee for taking the time to listen to all of our remarks about such an important topic.

The title of today's presentation or discussion is the Implications of Passive Investing. Plain and simply, the biggest implication of passive investing has been the benefits to the retail investor. The mom-and-pop investor buys total market fund for his or her retirement, the 401(k) participant using an index-based target fund or the financial advisor who builds a balanced portfolio of broad-based market ETFs. Indexing over the last 40 years has brought extraordinary benefits to the everyday investor to include diversifying portfolios, globalizing portfolios, enabling parents to save their children's education, coming the go-to vehicle for 401(k) plans, and overall democratizing professional investing.

It's also saved a lot of money. Our estimate is since the early 90s, \$186 billion in fees have been saved or the choice of index investing over a higher cost active alternative. It's the \$142 billion since the global financial crisis.

It's always worth a minute when we talk in a panel like this to remind ourselves why this occurs. It's simply the zero-sum game. All investors together give the the market return -- asset-weighted market return. It means half of investors are going to do better and half are going to do worse.

Once you account for fees, active investing -- excuse me, passive investing outperforms roughly 80 percent of active investing. You see that in many number of studies. The most recent, which I read was the SPIVA study by S&P, but it's well-covered in the academic literature and by market participants. It doesn't however mean that active can outperform. It's just a challenging and difficult thing to do.

(Inaudible) this is magical. They're getting an above-average return for lower risk and without the chances of selecting the wrong active manager. Furthermore, we believe that passive investing has also pushed the price of active management down. It's been competitive in that regard. It gets also -- and you're going to hear it today. You can certainly read it in the press and -- and other places. There's some things index investing or passive investing hasn't done.

It is by no stretch creating a market bubble or a momentum strategy. Index funds don't determine the price of securities. In fact, with a slightly different statistic than Jeb, I'll just remind you that index investors in the U.S. only make up as an ownership about 15 percent of market capitalization, and globally only 10 percent. But the key statistic to us is it's only five percent of the trading volume. That means 95 percent of the participants are, in some ways, actively setting a price.

Who are those folks? They're active managers, they're hedge funds, they're activist investors, company stock programs or high-frequency investors, retail participants. There's a plenty of price discovery in the market. The index fund is not the price maker, it is the price taker.

Second thing we would say that index investing is not going to cause nor has caused this market volatility. Market volatility is largely in a broad-based driven by geopolitical events, by monetary policy, by economic conditions. It's not driven by the choice of investors. In fact, I'll just point out, in 1929, we had a market correction nearly 50 years before the index fund was even invested. We'll have market volatility in the future. We've had in the past, it's not caused by index funds or passive investors.

There are some things we do worry about in the passive space. There's certain products that are probably inappropriate for retail investors, leverage product, inverse product. They may perform properly, but there's just not proper for a retail or an everyday investor.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Finally, and this was referred to by Jeb a minute ago, there are some products that are active in nature, but are passively constructed. A simple example is that what's referred to as a smart beta product. It's either smart or beta. It's an active position. It will perform differently than the market and therefore, by definition, it's neither smart and always going to win or beta and represent the market. I think those are couple things to think about as we think about the marketplace.

Finally, in conclusion, we just thank the Committee for taking the time to listen and discuss the implications of passive investing. As you go forward, I would suggest keep in mind the enormous benefits that passive investing has had to retail investors and be skeptical of what you might hear as some of the causes of this trend.

COATES: Great. Thank you. And as a Vanguard investor, I thank you. I -- such a small amount, I have no conflict here, but anyway.

(LAUGHTER)

Next, we have Robert Sharps, Chief Investment Officer for T. Rowe Price for a different perspective, I suspect.

SHARPS: Good afternoon. And I'd also like to thank the IAC for focusing on these issues. I think they are very timely. I would agree that the rise of passive -- passive and I would say broadly, rules-based investing, so not only passive but factor-based investing, quantitative investing, momentum investing has been one of the most important trends that we've seen the course of the last decade.

Obviously, while functioning markets are essential to efficient capital allocation and beneficial both to issuers and to investors so, you know, I think it's great that you're having a -- you're having this -- this discussion. My role on the panel today is to bring the perspective of an active investment manager. T. Rowe Price manages over \$1 trillion in -- in assets on behalf of its clients, and over 95 percent of that is actively managed.

I have basically been asked to speak to whether T. Rowe Price has observed any market developments that might be attributed to the proliferation of passive investment strategies or other rules-based investment strategies. And the short answer to that question is yes. It's always difficult to prove causality. And I think you can generally find studies to support either side of this debate. I think you're kind of many of the numbers with regard to the percent of trade volume or the percent of AUM market capital float are, you know, kind of really determined on how you approach it. And there is a numerator and denominator impact that, you know, can lead you to very different conclusions depending on what approach you take. This issue is most acute in U.S. equity, although it is a trend that's becoming increasingly prominent across asset classes.

Look, I think common sense would -- would suggest that any shift of this magnitude is bound to ultimately have consequences. I'd characterize the observable impacts today as either temporal or minor, but you heard the -- the magnitude and persistence of the trend. And, ultimately, I think if those trends persist, the impact is likely to become more prominent.

It honestly is our sense or my sense that we will get a clearer picture of the impact of the shift to passive investment strategies and indexation during the next bear market. There are alpha cycles. I think we've been in a particularly difficult market environment for active investment -- active investing relative to passive. Not to make excuses, but there have been periods of time where the statistics have been much more favorable to active.

So, specifically, what are those observations? And I'll group them into market structure and price discovery as well as corporate governance, which I think was meant to -- to be included in the scope of this.

From the perspective of market structure and price discovery, I'd say that -- that our -- our investment professionals, our portfolio managers and analysts note several concerns that are likely attributable at least in part to the trend towards indexation and other rules-based investment strategies. The first is that we do see evidence that strategies delivered in exchange-traded products can increase the correlation among constituent securities and periodically distort the price of those securities. And this is going to get a little technical, so bear with me for a second.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

But we basically observed this distortion is particularly acute and trading volumes are elevated in exchange-traded products, particularly downside trading volumes and oftentimes when there's a shift in market sentiment. We observe these conditions in downside volume in the high-yield bond market in early 2016, and again in upside volume in the small cap stock Russell 2000 market post the presidential election in late 2016. In each of those instances, our portfolio managers noted measurable distortion in the performance of underlying constituent securities.

I think the clearest example that I can share with people occurred about three years ago. In the fall of 2015, there was substantial -- substantially elevated downside volume in the shares of the healthcare spider -- healthcare select spider front, so actually you got a health care sector ETF. Basically, it look like the downside volume was being driven by intensifying political debate around pharmaceutical pricing. And in the aftermath of this we did a study and basically looked at the performance of the underlying securities.

What we found is heightened constituent correlation that all of the securities underlying the health care spider were depressed as you would -- as you would imagine, but there were several securities that had very limited exposure to human drug pricing. There are a lot of names that had, you know, kind of what statistically could be shown as very limited historical beta to this ETF.

Despite that fact, these stocks went down during a brief period of time much more than their historical betas would suggest and, ultimately, they recovered a third bit of that, which, you know, again suggested to us that the proverbial baby was thrown out with the bathwater. These conditions present themselves relatively frequently. We observe them happening dozens of times of year over the course of the last 10 years, which was the scope of our study. Although in some instances, they're broader and more intense than others.

A few other comments with regard to market structure. I would say we're seeing a continued concentration of trading volume late in the day. Passive strategies generally seek to transact at or near a securities closing price in an effort to replicate the performance of an index. And I would just say it's worth taking a step back and in saying that active management basically drives price discovery and also provides liquidity. Trading volume simply seeks to match the closing price, leaves less volume engaged in the price discovery process necessary to actually set that price as opposed to just trying to replicate it.

If -- as active managers, we choose to engage with that volume. We are basically forced to trade later in the day. And what we find is that concentrating volume late in the day limits intraday liquidity. It's well-documented. The spreads tend to be wider during the middle part of the day, and intraday volatility can be heightened as a result.

One emerging concern we have is that increased volume on a close, coupled with higher fees from the exchanges to -- to trade on the close to their market on closed facilities is leading to the rise of so-called broker sponsored market on closed facilities. These are now competing for end of the day volume. This is an emerging trend, so I wouldn't say that it's having an emerging current impact, but I do believe that it bears monitoring as it's diverting volume from the exchanges and ultimately risk fragmenting the market.

Last, what I'll make on price discovery is that in certain cases it's become more challenging for active managers to accumulate or liquidate positions in small and mid-cap stocks due to passive strategies holding 20 percent or more of the float of many, many small and mid-cap names. The vote turnover of passive strategy naturally limits the amount of volume that we can engage with if we're trying to build or trying to exit a position.

I see I'm running short on time based on the yellow light here. A few words on -- on -- on governance. I'd say our approach to governance as an active manager is unique in the sense that we have a -- a -- a governance committee, a proxy committee that focuses on the top-down issues, but our votes are also informed by our bottom-up fundamental perspective and intimate knowledge of each of the investments that we're making.

I'd I say we recognize, as a firm, the many of the passive investment managers have invested heavily in their ability to assess and evaluate governance issues and we'd say that broadly we believe that they vote their proxies responsibly. We actually think that the -- the -- the top-down approach that many of the passive sponsors take and

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

the bottom-up approach that we take tend to -- to -- to work quite nicely. That said, I would say as passive continues to become a greater share of the market, it can be quite frustrating when you do have some of the major passive sponsors being swing votes in contested situations.

Statistically, Vanguard tends to vote much more frequently with management than -- than many of the active firms and even some of their peers. And oftentimes in contested instances, they do -- they do end up determining the outcome, which can be somewhat frustrating.

So I would say, in conclusion, look, I think the -- the role active management plays in price discovery, governance and capital formation is absolutely essential. We believe markets function best with diverse perspectives and approaches and that active and passive can coexist in reasonable balance. We do believe there are periodic dislocations that eventually are bound to get worse particularly in extreme market environments to the extent that the -- that this persists. And we would caution the IAC with respect to policy recommendations that include a default to passive investment strategies and resist any type of regulatory policy recommendation that promotes one strategy, either active or passive over the other.

So, I see I'm out of time and thank you.

COATES: Great. Thank you very much. Stephen, do we have Professor Kahan available? How do we make that?

KAHAN: Yeah, can you hear me?

COATES: We can hear Marcel. Are we going to have visual or just a -- just phone? But, Marcel, why don't you go ahead while we figure out how to get your -- your picture up? In any event, next is Professor Marcel Kahan who was among the first people to encourage me to teach. So, thank you, Marcel, for that. And he's currently the George Lowry Professor of Law at NYU and a colleague of Ed Rock who we saw earlier today.

KAHAN: Thank you all for having us here. In my remarks today I want to address the implications of passive investing (inaudible), the (inaudible) of capital markets (inaudible). But before I (inaudible) I want to (inaudible) asset investment into context.

For (inaudible) we have seen a very substantial decline in retail holdings of shares and most of the institutional holding. Within the institutional sector, (inaudible) passive investing comparatively smaller and more (inaudible). (Inaudible) further management by hedge funds.

In considering the implication of passive investing, we need to consider all these trends. This is particularly evident with respect to the degree (inaudible) reflect available information that is stock market efficiency. One important factor that contributes to stock market efficiency (inaudible) analysis could not (inaudible) as we heard by the (inaudible).

Active (inaudible) investors (inaudible) to make stock market efficient. But for the most part, we (inaudible) retail investors, so a shift from retail to industry investors (inaudible) from stock market (inaudible). (Inaudible) could (inaudible) from the stock market efficiency, but the shift towards hedge funds (inaudible) efficiency (inaudible) hedge funds from one (inaudible) mutual funds. Taken together, it is unclear (inaudible) among the (inaudible) analysis.

Moreover, even if it turns out (inaudible) has declined and look for two (inaudible). First, (inaudible) will be (inaudible). As stock prices become less efficient, the (inaudible) increases and for those (inaudible), right? (Inaudible) will just keep growing and growing and growing.

Second, in our current market structure (inaudible) substantially more on (inaudible) obstacle from a financial perspective. A lot of research has been able (inaudible) on the market, which is effectively (inaudible). Stock market (inaudible), but despite this (inaudible), stock market efficiency (inaudible) in secondary markets is very different from economic efficiency, the (inaudible) production, allocation (inaudible).



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

From the economic perspective -- economic efficiency perspective, (inaudible) take 10 seconds, 10 minutes, 10 hours or 10 days to reflect new information. So securities (inaudible) make information available for market participants (inaudible) on a legal basis, but the (inaudible) basis for our fund (inaudible) for the SEC to encourage additional expenditures (inaudible) analysis (inaudible) make the stock market (inaudible).

And also with the second issue in terms of passive investing on corporate governance, if we (inaudible) information (inaudible) through superior performance (inaudible) portfolio manager (inaudible) and cast their votes.

(Inaudible) investment (inaudible) predominant (inaudible), it is predominant for (inaudible). First, we determine the amount of (inaudible) is a value increasing (inaudible). It's true that we talk about index funds or asset funds, (inaudible) the various assets in the management and anything that the (inaudible).

Second, the size of the investment determines the likelihood (inaudible) that it will affect the outcome because the (inaudible), which will provide a fair degree of (inaudible) to have (inaudible) that maximize value. (Inaudible) I should say (inaudible) because of the outcome of the (inaudible).

What about the (inaudible) because (inaudible) the (inaudible) the company. I'll also make two quick (inaudible) that I'm happy to elaborate later. First, (inaudible) of shares of commercial fund (inaudible) substantially will completely (inaudible) of the investors (inaudible) are established. There are some slight differences (inaudible).

At the fund family level, the (inaudible), they are paid (inaudible) fund. At the fund family level, the (inaudible), they are paid (inaudible) fund in order to decide (inaudible) fund. Index funds that doesn't have the effects (inaudible) fund.

And second, (inaudible). And there is strong evidence (inaudible) that even (inaudible) funds (inaudible) (AUDIO GAP) shareholders (inaudible) problems and (inaudible) conflict of interest. Index funds are not all alike, but there's no basis of (inaudible) or having some (inaudible). Thank you very much.

COATES: Professor Kahan. And last but not at least, Bob Pozen, also an old friend who's now a senior lecturer at MIT, but more importantly, I think, for our purposes has a long career both at Fidelity and MFS, and has been a close observer of these markets. So, Bob?

POZEN: Thank you, John, and thank you, Madam Chairman. Let me focus on the potential regulatory actions that the Committee might consider are non-actions. I think the others because have done good job at reviewing the economic and financial issues. So I'll make six points. The first one is that I would urge the Committee and the Commission to be neutral between passive and active. And I would urge that partly because of what people have said, index funds are price takers, so we do need active managers and active (inaudible) to set the price.

And second of all related to that, while, on average, active managers don't do as well as index funds, some actually do -- Peter Lynch at Magellan being the best example. But we also have asset categories that are less efficient where index managers may lose to active managers. And so we will let the market determine that.

Second of all, picking up on what Rodney said is I believe there is a class of index funds that are -- where there is a labeling problem and they're mainly ETFs, which as we know are mainly indexed. But we have leveraged. We have short in ETFs and they're usually high cost. They usually involve considerable conflicts of interest.

We have a lot of them in pretty niche markets, but I don't think they should be called ETFs indexes because they're really so different than what people have come to expect as an ETF index that we ought to try to label them differently because otherwise, I think investors really have very little idea about how differently they behave and how much more costly they are.

The third -- third point, which is maybe even more provocative is, you know, we saw today in The Journal Ron O'Hanley and Bill McNabb, two friends of mine, wrote a nice piece saying we should encourage IPOs more because we need more public securities for retail investors to buy, and we don't want all these securities to be in the private market.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

So, I note that index funds don't buy IPOs, but that's the way it is now. It -- I don't believe it's necessarily has to be that way. You could think of an index fund with appropriate disclosure that said, "We're going to buy IPOs of companies that are likely to qualify for index," or you could even have an index fund that said, well, we have a sort of side pocket of two or three percent or five percent, which buys IPOs. So as long as there was appropriate disclosure, I think that the idea of having an index fund that buys IPO is reasonable, and it would be an important factor in terms of bringing to bear this huge pool of capital to the IPO market. And I think it's really worth serious consideration on the Committee's part.

Fourth point is on the corporate governance side, I would agree with Rob who made their position that we shouldn't -- we should again be neutral. We shouldn't be taking away. I know that John wrote the Chicago schools somehow think we should take away votes from index funds. And then there are other people who think we should add votes because they're long-term. My view is we should be neutral and that's the way we ought to be.

A fifth point is picking up on something Marcel said is I think we have to understand the voting of index funds and, in most cases, can be general. And I'll talk about that in a second. But when we come to activist, index funds are important fast followers. They don't initiate anything, but once an activist comes into a stock and proposes a program, essentially, what the activist is doing -- think about it, they're not making a tender offer. They're not offering you money. They're offering you a program, which they think will increase the longer-term value of the stock.

And the answer I believe is sometimes it -- the program is good and sometimes it's not so good. But what we need is an intelligent and diligent group of large investors who are really analyzing this very carefully and hopefully coming up with the best answer. And I believe that places like Vanguard, and State Street, and BlackRock and Fidelity do a pretty good job partly because they're so big and partly because many of them have active funds that follow these companies.

But these are very specific proposals. You can't evaluate them on the grounds whether this is good for corporate governance or not. These are very company-specific proposals.

You think about the DuPont case. It was a proposal to split the company in a certain way and, you know, you could either think that was a good thing or not such a good thing. The vote was very close, but what we want to make sure is that index funds managers are diligent and are willing to be company-specific when it comes to activist vote because those are the most important. Those of the cases in which the shareholders are really deciding whether to have this management team or a different one, whether to have one strategy versus the other.

Sixth point, last point I want to make is about the more general proposition that index funds will promote generally good corporate governance because they can't buy and sell individual stocks. And this is a position which most of the big index managers take. And I guess, my view is it depends. In part, this may be true if the practice that's being supported is systematically going to lead to higher value. The problem is that some of the practices that are being supported may or may not lead to higher value. The evidence is mixed.

The best example is having an independent share of the work. So we know that the evidence is mixed, so we really should be reluctant to have an index fund to say we do this to promote better corporate governance and presumably better performance of these companies.

Everything that I just raise is a -- the similar thing, but probably even more controversial is to the extent that index funds get into ESG, I think again they need to be able to say that -- that sort of ESG they're interested in and there are lots of definitions are -- is ESG that promotes long-term value systematically across the board if that's what they're saying.

If, on the other hand, they want to -- some index funds want to pursue ESG for, let's say, social reasons, I think that's Okay, too. You can -- you could have an index fund that says this is what we do. We're an index fund, but we vote in a way that promotes ESG. We're not sure whether it will learn -- lead to higher financial returns, but this is what we have. And then if you decide as an investor, you want to do that? Great.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

So those are my six points. I can see I'm in the red light zone, so I will stop.

COATES: Terrific. Thank you all for that. And I'm happy to take questions from the Committee. I have many questions. So if we -- nobody has any, but so far I saw Damon first then J.W., then Heidi.

SILVERS: Thank you, John. Before I ask my question, John, I want to acknowledge Marcel Kahan who -- who taught me bond law a long time ago. And I am just completely mystified as to how it is that I aged 20 years and he didn't.

(LAUGHTER)

And so it's just a great pleasure to see -- to see him even on the screen. You know, speaking about long-ago experiences in education, 20 years ago I was in the Harvard Business School classroom at the end of my Harvard Business School education in a -- in the most advanced finance class. I had some fancy title. And one of the students in the last class asked the professor whom I'm going to leave nameless in case he's doing any consulting work these days. They asked him how should I manage my money personally and -- oh, how should we manage our money? What advice would you give us as we leave Harvard Business School and go on to great wealth? How we should manage our money?

And so keeping in mind that this is about a sophisticated crowd of people as you could kind of imagine short of, you know, a group of actual active traders, what what the professor said who, at that time, was, in fact, a consultant to a number of a very large and lucrative financial houses, what he said was, "You have two choices." He said, one choice is you -- and again this is the technology of the 90's, he said you could buy a Bloomberg terminal and install in your den and spend eight hours a day in front of it.

He said, "I think that you're a smart guy and that if you do that, you outperform the market." He said, "But if you're not going to do that. my advice to you was the same advice I give my great aunt, which is buy -- buy Vanguard funds."

I haven't seen a single piece of data that -- that in the -- in the ensuing 20 years that suggest anything -- anything has disproved that proposition. And it's one of the reasons why I'm a fan of big institutions as -- as investors because they can buy Bloomberg terminals and have smart people sit in front of them all day.

Me, personally, I invest in index funds. And so I'm skeptical -- deeply skeptical about the notion that there's any -- that -- that particular in light of the fact that what index funds have done is save a lot of people a lot of fees. I'm just sort of deeply skeptical that there's any problem here. The -- the -- at all. And -- but I -- but I would like to ask the panelists about the one problem that does bother me a little bit about index funds.

We are, after all, in that period of time when we are celebrating the 10th anniversary of the -- of the financial crisis. And one of the things that happened in the financial crisis that has kind of been forgotten now is that various classes of securities didn't do what they were supposed to do and various styles of investment management didn't do what they were supposed to do in the crash.

There were problems with money markets. There were problems -- very severe problems with lifestyle funds that were did -- were not designed with the people were told they were designed. And there were problems with hedge funds that just ended up performing exactly like an index fund.

The money market funds, in particular, the problems with the money market funds raised disintermediation issues that the -- the funds could form as -- as -- as promised in terms of keeping the dollar. And so what I'm concerned about and some of the testimony here sort of brought it to the floor, what I'm concerned about here is the question of under stress, are the -- are the structures we have in the index space, both ETFs and mutual funds, are they -- and are there significant differences between the two in terms of raising disintermediation problems under stress? And is this something that the -- that we should at all be concerned about as the -- as the assets -- as the -- as the asset class grows. So, I put that to you all.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

POZEN: I'll be glad to talk, but I think Rob should really elaborate. I think there is a much greater problem under stress with ETFs than index funds because of the mechanism that ETFs use with these authorized people. And so the evidence he gave is ETFs, and it's not surprising because there can be quite a **big** gap between that.

On index funds, you don't have that sort of gap, but I think probably just blue skying it, we haven't really had a time **in** which there would be huge redemptions of index funds. I mean, part of the tax efficiency of index funds is that they're gradually buying a little. So we don't know that much. It's probably true that the **S**&P 500 is a deep enough market that there'd be relatively little, you know, **side** effects.

But now that we have indexes on almost anything, I noticed that there was an ETF now. I think it's called the country music ETF that has only companies **in** the Nashville area.

(LAUGHTER)

So, I hesitate to ...

(UNKNOWN): It's (inaudible) ...

POZEN: ... understand what would happen **in** the time of stress for country music. But I think we have lots of indexes now that have lots of smaller and midsized stocks.

And so Rob may have more sense of what -- what happens **in** those markets.

SHARPS: I think there -- there is an issue. I think it tends to present itself more **in** less liquid asset classes during periods of stress or meaningful sentiment shifts. And I'd say probably most prevalent **in** sector or thematic exchange-traded product, but not entirely limited to that. **In** some of these instances, look, the vast majority of passive flows are going into exchange-traded funds, right, much more so than open-ended funds.

And **in** some of these instances, the exchange-traded funds does -- it does a poor job of replicating the return stream of the underlying index, and it creates an illusion of liquidity. As long as you're buying and selling between people that are interested **in** the exchange-traded product, that's great. When you have a meaningful imbalance from a supply-demand perspective, you've got to either redeem or create certificates and you've got to sell or buy the underlying security.

**In** instances like early 2016 **in** the high-yield bond market or late 2016 **in** the small cap U.S. equity market, the demand that was being channeled through those index products created dislocation **in** the underlying securities. It raised the -- the -- the correlation among those underlying securities and distorted the prices for a period of time. Ultimately, it resolves itself, right? But you -- you have, as a result, the sentiment, fear and greed distorted prices **in** the security markets all the time. The question is how extreme do they get and how long do they last? Because the one thing that I would say is, given the magnitude of the shift, **\$**2 trillion plus over, you know, kind of the decade plus period of time, I think it -- it will become more prominent and will become of a greater magnitude.

If you have fewer people endeavoring to tether the value of an individual security to the underlying stream of cash flows that it's entitled to or represents, you're likely to have dislocations that last a longer period of time or are greater. Again, I think that they're -- they're, I guess, relatively infrequent **in** the **big** scheme of things **today** and for the most part relatively minor is the point is and I -- I wouldn't contest some of the claims with regard to their benefits of indexation. I mean, I think they're -- they're pretty clear for people who either don't have the resources or the interest to identify an active manager that can -- that can outperform.

But I do think **in** -- **in** the interest of thinking about liquidity, market, depth and price discovery, there is a point where there is too much of a good thing, right? And, you know, the statistics that -- that Rodney gave with regard to five percent **in** terms of passive trading volume, you contrast that to report that came out from J.P. Morgan last week where they say only 10 percent of trading volume and equities right now is security to security and really engaged **in** price discovery, right? Those are pretty extreme, right? Five percent versus 90 percent.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

The truth, I'm sure is somewhere in between and it really depends on the nature of how you structure it. But I -- I -- I think this is something that should be on your radar and bears -- you know, kind of it bears watching, particularly in areas of the market where there -- where the underlying security is much less liquid than the ETF creates the illusion of.

VERRET: I was surprised when I got here, but I -- I was glad to hear that the tenor of the conversation has been mostly, I think, about a need for the SEC to stay ambivalent about the difference between passive and active. And also I should say, you're talking about the heritage and legacy. I'm honored to sit next to my corporate law professor and then next to him was my securities law professor.

(LAUGHTER)

Can you imagine what a treat that was? And now I teach corporate and securities law. It must have been because they were pretty good at -- at that. So that was a real treatment. I'm glad you're all here.

So I -- I'm hopeful the Commission stays ambivalent between -- between strategies, both active or passive between types of passive products in the same way that I've hoped though. Unfortunately, the Commission is not always doing the best job of staying ambivalent between long and short or ambivalent between long-term traders and short-term traders.

POZEN: Let's call it neutral rather than ambivalent.

VERRET: Well, Okay, either way, either way. It's not the Commission's job to make those determinations, it's the market's job. And I -- I think that we have to appreciate. I think that if we brought in, you know, some of the folks in the active trading world, they would say that the returns to active trading generally tend to correlate with opportunities when we're active trading, which are created by the increase in passive investing.

But back to the specific recommendations, there -- there are a number of good ideas raised, I think, along the way that would be good ideas beyond a -- a -- a comparison between active and passive like taking another look at small companies. And -- and I think what -- what Mr. Sharps was alluding to was the -- was the portfolio restrictions on smaller companies that -- that '40 Act firms face.

And I guess, my first question is is that a good recommendation contained in the Treasury Department's report on - on capital markets reforms? Do those portfolio restrictions make sense anymore in light of other things that disincentivize large mutual funds from taking large positions in firms? So I think -- I think it's a 10 percent requirement where limitation we're talking about.

And then secondly on ESG, I appreciated the -- Bob's thoughts about disclosure. Do this discussion about ESG run deeper with respect to -- to the often unclear, but still ever present fiduciary obligations of investment advisors to the extent that recommendations are made beyond those that are economically defensible. Is it just a disclosure issue or are there some fiduciary obligations (inaudible)? Two questions.

COATES: And I -- I apologize. Anne waived to get maybe me to notice that Rodney might have wanted to respond last time. You have to give your -- yeah, go ahead.

COMEGYS: So again, I think one thing I just like to say is about the ETF structure, the ETF structure itself again the question. I think, in general, the ETF structure, as liquidity, is the second place of the market. It adds secondary trading volume, so ETF trader -- ETF trader actually makes up the majority of ETF trading. Alternatively, and I'm completely agreeing with Bob that ultimately though even with that extra liquidity, it's only as good as it's underlying positions. I'd also point out in sometimes there is an illusion of liquidity that may not be there in a point of stress or time.

Second thing we've always told investors is to make sure you can stand the volatility of what you're buying, so whether it's a narrow niche ETF, that may not be appropriate nor able to withstand the time period, and it's the worst time to sell is in a depressed market with stress.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

Then finally, I would say just 2008 tested the ETF market. ETFs performed exactly mechanically how they should. Unfortunately, for equity markets, that was a very large loss, but they remain liquid and they are made able to meet the needs of investors. That is a little bit because I think we sometimes lose sight of the fact while we talk about the things that are very small. The majority of index flows and the majority ETF flows, top 20 ETFs are all large-cap broad-based equity or bond-type vehicles. There are small high-yield in there, less liquidity, but these are very liquid vehicles.

By the way, in the time of stress and active manager also has to sell. They have to make two choices. They have to choose to -- how to sell and raise liquidity. They also choose whether to leave a less liquid position in their portfolio because they don't like price. That's a tougher ask. In expense simply goes proportionally across its portfolio liquidating 503,000 securities whatever it might be.

COATES: Right. Bob, you want to answer J.W.'s first question if you -- if you can? Robert, sorry. There's two Bobs.

SHARPS: With regard to placing restriction or limitation on the amount of a -- of a smaller mid-cap company that an investment company can own ...

(UNKNOWN): I think (inaudible).

SHARPS: Yeah, I'm -- I'm not familiar with that, right? I mean, I don't believe there's a 10 percent ceiling as it exists. I mean, we -- we -- we own north of 15 percent of many, many companies. There are industries -- banking, insurance, gaming where there are regulatory restrictions that might limit you to 10 percent ownership. There are instances where there might be a poison pill, but I'm not aware of any existing regulatory restriction on an investment company's ability to own more than 10 percent of a company on behalf of its clients.

COATES: Great. Then Bob on ESG?

POZEN: On the ESG, I think you're -- I would say that fiduciary and disclosure come together. They don't always come together. But since ESG is a very diffused term, it means lots of things to lots of people. I think the key is that whatever the fund is doing, whether it be an index fund or not an index fund on ESG that I just disclosed to the -- the shareholders so that they can feel comfortable with the fund.

As we know, you know, if -- if investors are there because they want to maximize financial return that you can have an ESG strategy that's consistent with that, you just say that. But you can choose to -- we know there are social funds, and there's no reason why you couldn't have a index fund with the social voting agenda as long as it's disclosed. So, my view is that sort of a -- there isn't as -- as long as we're disclosing the shareholders, what we're actually doing, why we're doing it, what we expect to do, if they buy in, you know, for a mutual fund that's Okay.

(UNKNOWN): You think the big guys need some work on that (inaudible)?

POZEN: Well, I -- I think -- I think that it's too -- it's too quick to say we take an ESG approach because it's going to bring about long-term financial returns. It may in certain types of ESG different, and if that's what you're holding out to investors then you ought to deliver. But you don't necessarily have to do that, but if you're going to do that, you ought to spend some time to make sure that what you're doing is systematically going to promote long-term financial return if that's what you've told investors.

COATES: Heidi?

STAM: Yes, thank you to all the panelists for contributing to our education here. And as I listen carefully, I -- I do hear in a couple of different camps that there's not a lot to do here, but we do need to be smarter and understand these markets.

One thing that I observed just in the commentary, I think we paint with too broad a brush when we say passive. I mean, that can -- that means a lot of things. It means different things to different people. There's obviously a place

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

for active and passive investing. They all contribute to the marketplace. But as I listen, I hear things, well, index funds don't invest in IPOs. Well, they do.

Index funds follow activists, well, so do active managers follow activists in various activities. So I just would caution the group and ask for comment from our experts about, you know, how we might think about this over time and not fall into the trap of bundling this entire market together, but looking at it where the problems, if they arise, they may be because they're in a very small illiquid market or because there is something else that's s going on. I -- I just worry about whipping everything together. So any comments on that would be (inaudible).

POZEN: Well, I would agree with you, Heidi. I think one important distinction we've been making is between ETF index and index funds because I think they do operate differently. Second one, which we've talked about is index funds, which are the bulk of the assets that are in these very deep asset classes versus ones that are in thinly traded. And so I think those are two very important distinctions.

And then, you know, as you say passive includes lots of different strategies, some of them very complicated derivative strategies, et cetera. I don't think that's s what we're really talking about here. We're -- so far we have been talking mainly about mutual index mutual funds and index ETF.

DOGETT: I would just going to make a comment about the ESG point. In some sense, that's s a little bit like a fundamental index, right? It's s something a little different. And to the extent that a manager wants to put forth that they have a kind of commission-based portfolio and that's s consistent with the values of the investors, and they make that choice and it's s disclosed, and there's s been -- it's s really -- that's s -- that's s just a choice that the investor has to make. They're not really making a promise about what the return is, it's s just more about invest along the lines of your values and its best efforts.

COATES: Great. Lisa?

FAIRFAX: Thank you. So, thanks to the panelists, I want to echo that as well. I teach a seminar on shareholder activism and influence. And just last week we were talking about the rise in passive, so this is right on target that I can now bring back to my students so they can know I'm telling them the truth.

(LAUGHTER)

I just wanted actually -- and this follows, I think, very nicely on to what Heidi just said, but wanted to -- specifically with regard to both Robert's s observations regarding corporate governance. And for me, I -- I think I was a little puzzled as to what exactly you wanted the takeaway to be with respect to that. And -- and I feel like maybe that is because I was feeling like maybe you were bundling all of -- kind you are using passive and its relationship to corporate governance in a way that suggested no differentiation.

So I guess, two questions. The -- the first is is it your view that the corporate governance strategies associated with passive is somehow different that there is a kind of fundamental distinction there that we should be concerned about?

And -- and then the second is it's s really, Robert Sharps, when you -- and he said something and maybe I just didn't catch it about corporate governance. And the concern we should at least be starting to think about, I was trying to puzzle through, should we be concerned because they're not voting with management? Is it because you think they are not voting responsively? Is it a disclosure point? I just wanted to kind of unpack and get a little bit more clarification around kind of what you think we should be thinking about in relation to the corporate governance issue.

DOGETT: I'll try to address both of those briefly. To some extent to further Rodney with regard to how Vanguard approaches the governance process and how they vote their proxies, my understanding is that most of the large passive investment sponsors -- Vanguard, BlackRock, State Street -- have invested very heavily in their governance teams and their ability to analyze and assess high-level issues, issues with regard to shareholder

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

rights, issues with regard to compensation -- compensation and incentive structures, issues with regard to staggered boards -- all of the sorts of things that -- that, you know, kind of generally come up.

I do believe that our process is different. And I think the point that I was trying to make is I actually think that the active -- that the approach that we take and the more top-down issue-oriented approach that the passive folks take tends to work reasonably well together.

We actually delegate proxy voting responsibility to our portfolio managers. We actually believe that voting proxies is an investment decision, that they are the fiduciaries that are representing our client's s interest and they're best positioned to decide on, you know, kind of all of the issues. In many instances, it -- you know, it's s kind of relatively straightforward. There is not something that's s contested or controversial and it will be -- you know, kind of the vote will be very consistent with what our standard policies are from our proxy committee.

In instances where there is something that requires more nuance, lead independent director or, you know, kind of -- you know, or -- or, you know, independent chair, it depends on the situation. And I think our investment professionals, our research analysts and portfolio managers are very well-equipped to determine the right way to vote in those sorts of instances.

So, I think the question basically to me was do I view the way active investors vote proxies as being different than the way passive investors do? And I do. I think most active investors look at governance as a question of investment decision-making at the security level. And I would say, you know, without speaking on behalf of the passive votes that, in general, they tend to view it from a top-down policy level. What are our governance policy is going to be? And I would say that there -- there are more uniformly applied, maybe not entirely uniformly applied, but more uniformly applied than they would be at your price.

POZEN: Yeah, I just want to follow-up and say that I think I agree with what Rob -- Rob said. I think the activists present sort of difficult situation for some index funds that don't follow individual companies because these programs of these activists are very company-specific, they're very detailed and usually management disagrees. And so having analysts who know the company deeply and followed it for several years gives an insight. And as I said, place like Fidelity and BlackRock happen to have active, you know, analysts itself. But if you had an index fund that didn't have someone who say covered DuPont, well, then they have to make a decision to get up to speed on the very specific things.

Nevertheless, the index funds are the arbitrator on a lot of these activists, so we really do want them to get up to speed on the specific issues. And for the smaller index funds it could be a resource issue. I'm just not sure.

COATES: Rodney?

COMEGYS: I think it's s important we just take a minute and talk about what an index firm like Vanguard does and how we do proxy voting. So, first of all, we are a passive investor when it comes to investing in the market. We're not devono (ph). We have a responsibility for the long-term value of our shareholders. We have fiduciary responsibility very seriously. And as Robert mentioned, we put a lot of resources to it.

On many issues, such as governance, we are top-down and we are philosophically trying to find the ways in the governance system and in the way companies report to ensure that we have the -- that the world has the best information to the long-term value. However, when it comes to something like a shareholder activist versus management, we have to take possession and we take that position very seriously. We take a ton of inputs in every input that we can take, including, I'm not sure people recognized that Vanguard has over \$1 trillion of active management assets and 30 different sub-advisors that we use. We're certainly going to take their input as we decide a controversial or a tight vote.

We'll even take the information of T. Rowe Price's s active managers as an input. We're glad to take it. We're a passive investor, we take information very well. We want to make the best decision. We have an obligation.



SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

There is a nuanced difference, though, between any active investor and a passive investor. And sometimes our vote may be different for simply this reason. The active investor has the opportunity to increase value. It may be in a short-term like an activist typically would next the position or even a good active manager with this time period that's not indefinite. We have an indefinite holding period for our companies and, therefore, sometimes we can have a good decision that's a different decision. And so that's how we go about voting our proxies and we take it very seriously in a very active way.

COATES: Great. Jennifer, last question.

MARIETTA-WESTBERG: Thank you for your time and expertise in talking to the panel today. When I hear about the rise of passive investing, sometimes it seems that that trend is being extrapolated that the rise of passive funds will continue unabated. And as J.W. noted, the rise of passive funds should create opportunities for active funds. And in thinking about the need for regulatory intervention, we're often looking to what is the market friction or the market failure that drives that need. So, is there a market friction that is stopping the market from finding its own equilibrium, active and passive investments?

DOGGETT: In -- in the long run, I don't think so. In -- in the short run right now, you know, I think the -- the -- we have bid in an environment that heavily favors cap-weighted indices in U.S. equities. And as a result of that, the -- the -- I'd say fundamental case for passive has been further reinforced by what I'd call kind of a recency bias. The statistics in terms of the percent of active managers that outperform the benchmark are at a cyclical lower point than they have been if you look at them in the fullness of time.

There is, I think, a very prevalent narrative in the marketplace that passive is always the right solution because it's lower cost. And also because you don't -- you won't underperform a benchmark.

Underperformance is not risk. You know, I -- I think if you look there have been periods of time where there -- the median active manager has outperformed passive for an extended period of time, it tends to happen after inflection points when the cap-weighted indices lead to concentrated exposures. So, Japan got to be about half of the weight of IFA in the late 80's. And for an extended period of time in the 90's, active management, you know, was able to feast on that reversal by simply being underweight Japan.

Technology, media and telecom, as an aggregate, at the -- at the end of the 1990's became a very large portion of (inaudible) basically half of the market cap of the S&P 500 an extended period of time in the 2000s where the median active manager -- large-cap active manager outperform. I also think there's a bit of a generalization on behalf of -- or the -- to the benefit of passive. I think people take the statistics that are broadly looking at S&P 500 relative to active domestic equity and extrapolate them to a lot of different asset classes. The success rate away from large-cap U.S. equity is lower and, in many instances, the success rate of active management actually beats passive. And in many instances, the cost of passive are much higher than what are promoted.

I think the Vanguard folks are much more transparent. They do do, you know, cover a very good job, and I think there are some passive sponsors, and there are some passive products, whether it's emerging market equity, emerging market debt, bank loan where the index replication is very poor, where the costs are high and, ultimately, an active management product, an active solution is better.

And right now I think the narrative is so strong in the favor of passive that people are really, really afraid almost in certain instances, fiduciary instances to consider an active alternative even if it is in their own best interest or the best interest of their client.

POZEN: I think we have no reason to believe that the market won't reach an equilibrium. It may very likely be a different equilibrium point for different types of indexes and different types of asset classes. But presumably if 90 percent of the S&P 500 were an index then active managers would easily find a great opportunity. So I think there is, but we have no idea what it is. We have no idea whether it's 50 percent, 40 percent, 60 percent, but my strong intuition is it's a different number, different percentage for different asset classes and different indexes, different constructions.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

COATES: Rodney?

COMEGYS: Yeah, so I do think there is probably one structural impediment that makes it tough or active. It's s the fees, so the fees of an active fund, I apologize, for 2016 it's s 75 basis points on average. It's s not a reflection of the folks over here, but that gives you over 50 basis points headwind right off the bat, so as active funds come down in price, they'll compete better. They'll have less of a headwind to overcome.

Active management is really hard. We believe we have a trillion dollars of assets under management that we want to outperform every day. It's s a competitive world, very smart people.

(Inaudible) the example earlier of just great technology, great thinkers trying to outperform the market, activists competing with other active, and the fees actually make indexing work well. So I think that's s the structural impediment. As fees come down, you might see equilibrium hit sooner.

COATES: Great. Terrific discussion. Did Damon put his tag back up? Okay, very quickly, I hope.

SILVERS: Yeah.

COATES: Yeah.

SILVERS: A very brief question that was raised by something that Bob said earlier and then that Rodney said just a couple minutes ago about the -- the tension perhaps between -- and time horizons in active and passive. And the question I have is what does that mean in term -- what are the implications of that and should we be concerned about that in context where mutual fund complexes have the actives driving the corporate governance decision-making when -- when the tail is wagging the dog, so to speak?

POZEN: I know -- I think that complexes are very capable of having different votes for index funds versus active management if they have a different objective and a different time frame.

SILVERS: I mean, I -- you said earlier that you thought that it was a good thing, so to speak, that -- that the -- that the analytic shop that the active fund ...

POZEN: You know, they -- they have -- so that gives ...

(Crosstalk)

SILVERS: ... the decision-making.

POZEN: Yeah. Well, that gives them all the input that they need, but they can -- they could choose to make a different decision if they felt that the time horizon was really important, but they -- in order to do that they need a huge amount of information.

SILVERS: Yeah. I think this is an important outgrowth of this conversation to point out, as Rodney did, that there is a tension here and time horizons going active and passive funds. And by the way, I just note something, Bob, you -- I really appreciated what you said earlier about the ESG issue.

In -- in my experience there's s someone in the -- who's s been involved in ESG stuff, there's s no major sort of, you know, return-oriented index fund that doesn't not apply to exactly the kind of criteria to these -- to corporate governance decisions that you suggest they should. It's s a very -- they are -- the index fund complexes are all, in my experience, extremely value-oriented. You -- you got to make that pitch on ESG. They are not running a cohort agenda as I have witnessed many times.

COATES: Any last? Great. Thank you all for that. I will -- I'll just leave since I didn't ask any questions, I'll leave you with one last thought. And I take Jennifer's s point that past trends don't predict future trends, but I understood the data presentation earlier to suggest that the trends driving the trend right now, the underlying factors driving the trends right now are not changing anytime soon.

SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR  
ADVISORY COMMITTEE.

And I do think the major friction is retail investors took -- how long did it take for Vanguard to get to work out? They were (inaudible) in 1976 ...

COMEGYS: Seventy six, '74.

COATES: ... four or six, somewhere in there. And they didn't really -- they didn't become the top ...

COMEGYS: Six (inaudible) passive fund except for the complex.

COATES: ... they didn't become the top bond fund until just recently, and they didn't become the top equity fund until 20, 30 years after the invention. The idea hasn't changed. It just takes a long time for that idea to penetrate the retail markets. And then having penetrated it's getting a lot of momentum even past equilibrium point that almost certainly will eventually happen.

So to that reason, heres my last thing to leave you with, I think we're going to go pretty soon already if you look at IBM's top three, the big three, you know, 20 percent. I think you add in the other indexes, they're not above five so we don't know where they are. It's probably more like 25 or 30. I think we're going to be at 50 plus percent of votes held by five funds soon for a lot of the S&P 500.

And I think even if you believe everything you heard about good governance, and investments, and different ways, and -- and -- and (inaudible) thing about it, that's a very different world to imagine having five people at least in principle sitting around being able to sway every vote for every major public company. And that's one thing to keep our eyes on, so I'll stop there.

Thank you, Anne. Turn it back over to you.

SHEEHAN: On that happy note, thank you all. This was a great panel and I appreciate you presenting to us. I really do. It was -- it was terrific.

So, for the Committee, last couple of things, I'm going to ask Matt to take about a couple minutes and just give an update on what your subcommittee is working on.

John Coates, I'm going to have you also talk about yours. I guess, I'll channel Barb Roper. Really it has been the discussion we had a lunch and look -- look to -- for an email from me about continuing further discussion on the -- the Reg BI recommendation.

So, Matt, why don't you take it away and then we'll turn over to John, and then we'll adjourn.

FURMAN: I'll just note for the Committee that, at our last meeting, the Committee adopted a set of recommendations on -- on retail protections in the corporate and municipal bond markets. One of the recommendations actually has come to fruition already, but the SEC didn't adopt amendments to Rule 15c2-12. And that was -- if you read the adopting release, you'll see a number of references to -- to the -- to the recommendations that we made.

We -- we continue to look at -- at issues related to small-cap liquidity and market structure impediments to -- to that. And we will continue to do that and may -- sometime have some of recommendations on that front. And those are the two main things we're looking at.

SHEEHAN: John?

COATES: Great. So, in our Subcommittee, we -- I have a draft that's been circulated, but we have not yet had time to discuss on possible additions to Reg SK related to human capital, which now, broadly speaking, represents a much bigger share of the value of large companies than certainly was when SK was written and even when it was less substantially revised. This is an invitation to some extent of Bill Hinman and others to help them think about how to respond to that shift, so that's something we're working on, but it's in early stages.

## SECURITIES AND EXCHANGE COMMISSION HOLDS A MEETING OF THE DODD-FRANK INVESTOR ADVISORY COMMITTEE.

And then we have a cyber risk, which this Committee has previously discussed in -- in public forum, which we'll come back to in light of that discussion. So those are our (inaudible).

SHEEHAN: Great. So, just a couple of things, as I say, look -- look for an email from your first staff and follow-up on our discussion on the recommendation.

And then, J.W., actually for December one of our panelists is going to be what is going on on ESG report and what are investors asking for from companies, what are companies reporting on, what are some of the models, you know, that are reporting, what's s going on at SASB, what's s going on at the TCFD, the -- you know, and what is the state of play.

This Committee had a hearing two years ago, I believe, on integrated reporting, and so I think it's time to sort of come back and say, Okay, how has the market changed in this? So apropos of your comments on the ESG.

And then we are also looking at the FINRA arbitration award issue and some of the issues surrounding that, you know, the collection of those legislation that's s pending and some other ideas in that regard. So that will probably be our -- our two panel discussions for December in addition to whatever issues the Subcommittees want to bring forward.

What I would do is we're always looking for, you know, topics going forward sort of strategically setting our schedule for next year. I think you all got the dates for our meetings for next year. Myself and the exec committee as we set the agenda are always open to ideas, so please do not hesitate to send me an email or send a note or whatever if you have some suggestions for like the topics today, you know, sort of big issues that we could tee up, perhaps some that may result in recommendations.

I'm not sure the second panel. This is more of a -- it was sort of an education, you know, just kind of watching what's s going on and what are the trends. I could see perhaps on the first, the proxy plumbing looking to maybe hear from the Commission if they have their roundtable and perhaps this group could come up with something on that. But I welcome any ideas that anyone may have in terms of topics that'd be of interest to the Committee.

So, any other comments, questions from the Committee members, either those here present or those on the phone? If not, then we will see you in December and we'll be chatting in the meantime. Thanks.

## Classification

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