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Frequently Asked Questions Regarding the SEC's NOBO-OBO Rules and Companies' Ability to Communicate with Retail Shareholders

The past several months have seen a resurgence in the years-long debate over proxy mechanics. One focus of that debate is the desire of issuers to have more direct channels of communication with their retail shareholders, and a dissatisfaction with the SEC's "NOBO-OBO" rules. This issue, and the SEC's current rules, will be addressed in a concept release that the SEC plans to issue in the near future.

In response to questions we have received about the somewhat complicated regulatory context for communicating with retail shareholders, we have prepared the below answers in order to better explain the SEC's NOBO-OBO rules and how they operate.

What are the NOBO-OBO rules?

The NOBO-OBO rules are rules the SEC adopted in the mid-1980s that govern when an issuer may obtain a list of its "street name" shareholders who have not objected to such disclosure. These shareholders are "non-objecting beneficial owners," or "NOBOs," while "OBOs" are shareholders who have objected to the disclosure of their identities and share positions. A shareholder is a NOBO by default, unless he or she has taken affirmative steps to object.

"Street name" holders are those shareholders who hold their shares through a broker or bank custodian. Under this form of ownership, the shares are technically "owned" by the broker, bank or other intermediary, so that only the broker or bank knows the identity of its client, the true beneficial holder. The other type of shareholder is a "registered" shareholder, who holds shares directly on the books of the issuer or its transfer agent. In the case of "registered" holders, the issuer either has a list or can obtain one from its transfer agent.

What information can an issuer obtain about a NOBO?

An issuer may obtain the shareholder's name, address and share position as of the date of the request. However, the issuer does not have access to the shareholder's email address(es), or the particular bank or broker with which the account is held.

How does an issuer obtain a list of NOBOs?

An issuer may request that a NOBO list be generated at any time, and must pay a "reasonable reimbursement" fee set by the New York Stock Exchange. The SEC determined that the list should be available from a single intermediary in order to benefit from "economies of scale" in gathering and storing the data. At the time that the SEC adopted the NOBO-OBO rules, the magnitude and allocation of start-up and ongoing costs were a matter of controversy. The NYSE convened a committee represented by interested parties, including the Society of Corporate Secretaries, on behalf of issuers. The committee recommended a single intermediary, with fees set by the NYSE.

What are the objectives of the NOBO-OBO rules?

The principal objective of the NOBO-OBO rules was to balance the interests of issuers, brokers and shareholders, both retail and institutional. When the SEC first began to consider such a mechanism in 1981, the reconciliation of interests proved difficult. Five more years would pass before the rules were implemented on January 1, 1986, and this was only after convening an SEC advisory committee and an NYSE advisory committee, each of which included representatives of interested parties. The principal interests to be balanced included the following:

- Brokers' interest in protecting their proprietary client information—pointing to their ownership of their own databases, and highlighting a concern that the transmission of client information by a broker directly to an issuer would allow the recipient to reverse engineer the broker's client list
- Investors' interest in privacy—pointing to their desire to avoid having their name, address and share ownership information provided to parties other than their banks, brokers and solicitors
- Issuers' desire to choose the mailing agent for communications with "street name" holders
- Technological feasibility and operational efficiency
- The allocation of related costs, including start-up costs, as well as ongoing costs such as software development, database maintenance and data storage

As noted above, providing investors with the opportunity to "opt out" of NOBO status addressed privacy concerns. The use of an intermediary addressed brokers' concerns because it permitted the transmission of a client's name, address and share position without any ability to associate the shareholder with a particular broker. The intermediary structure also addressed efficiency, as the SEC stated in 1985 that "economies of scale will be realized by permitting [brokers and banks] to delegate this function to an intermediary which will maximize cost savings while minimizing burdens on brokers." The fees for obtaining a NOBO list would be regulated by the NYSE. Banks and brokers would be required to promptly forward communications to OBOs on behalf of issuers.

How many shareholders are NOBOs?

Retail shareholders are predominantly NOBOs. Third parties who track this information estimate that 75% of all retail shareholders who hold their shares in "street name" are NOBOs. In contrast, the majority of institutional shareholders are OBOs.

Is elimination of OBO status a possibility?

Shareholders are unlikely to accept the elimination of OBO status without replacing it with another mechanism that in effect provides a similar election. The forces competing with the issuers' desire for the information have only strengthened. Since the mid-1980s, when the current system was implemented, institutional investors have only become more vocal about their desire to remain anonymous. Likewise, the general societal focus on privacy and data protection has only intensified. The forces driving investors' desire for privacy are the same ones that resulted in the adoption of the "do not call" list earlier in the decade, and are driving current legislative proposals aimed at beefing up data protection laws. Any new or modified system for disclosure of beneficial holders almost certainly will have to include an opt-out mechanism, just as the current system allows for OBO status.

Given the need for an opt-out mechanism under any scenario, it is unlikely that any new or modified system or approach would result in the disclosure of a greater proportion of retail shareholders. Indeed, in 2006 the NYSE sponsored an Investor Attitudes Study. Among retail investors surveyed, 79% stated that they would choose, if asked, to allow their identities to be disclosed to issuers. This matches almost exactly the current actual percentage of retail NOBOs under the current system.

What are the potential consequences of eliminating OBO status (i.e., the ability of shareholders to opt out of disclosing names and other information to issuers)?

If NOBO status were eliminated in its entirety, issuers would have access to a list of their shareholders at any given time, just as today they can obtain a list of "registered" holders from their transfer agent. Issuers would then be able to choose their own distribution agent for all shareholders, just as they could, in theory, do today with respect to NOBOs. In that case, however, it seems unlikely that elimination of OBO status would reduce the cost of soliciting "street name" shareholders, as costs would continue to include:

- the cost of generating the "street name" shareholder list, including technology and personnel to gather the shareholder information from numerous brokers and banks, and the organization and reporting of the collected data (including any start-up costs if the task is undertaken by one or more new entities); and
- actual communication costs, including printing, postage and any solicitor costs.

Why can't the SEC just get rid of the system that allows shares to be held in "street name"?

"Street name" ownership facilitates the efficient and accurate clearance and settlement of securities transactions. Following the "paper crisis" of the 1960s, Congress enacted legislation, and the SEC adopted rules and policies, designed to encourage "street name" ownership. As brokerage firms in the 1960s faced increasing volumes in securities transactions, their back offices found themselves unable to keep up with the processing requirements in a world of paper stock certificates. "Street name" ownership facilitates clearance and settlement because there is no paper that has to be transferred back and forth, and shares are fungible. While the system has been criticized as complicated, it is actually extremely modern and efficient, permitting the aggregate netting of multiple transactions among brokerage firms at the end of the day, rather than on a trade-by-trade basis. Because "street name" ownership is necessary to the efficient operation of the securities markets, its elimination is not on the table as a practical matter.

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