ii. *Amendment to Rule 11870.* Since the adoption of NASD Rue 11580, members have inquired as to whether the Standardized Transfer Forms can be used to accomplish account transfers under NASD Rule 11870. In order to clarify this issue, NASD Regulation is proposing to amend Rule 11870 to provide that in the case of limited partnership securities, members must use the Standardized Transfer Forms unless exempted by that rule.[4]

2. Statutory Basis

NASD Regulation believes the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act[5] in that the proposed rule change is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities and, in general, to protect the public interest.

*B. Self-Regulatory Organization's Statement on Burden on Competition*

NASD Regulation believes the proposed rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

NASD Regulation has neither solicited nor received written comments.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Also, copies of such filing will be available for inspection and copying at the principal office of NASD. All submissions should refer to File No. SR–NASD–97–05 and should be submitted by April 14, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[6]

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. 97–7281 Filed 3–21–97; 8:45 am]

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**[Release No. 34–38406; File No. SR–NYSE–96–36]**

## Self-Regulatory Organizations; New York Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change Relating to a One-Year Pilot Program for Transmission of Proxy and Other Shareholder Communication

March 14, 1997.

## I. Introduction

On December 6, 1996, the New York Stock Exchange, Inc. (''NYSE'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend NYSE Rules 451 and 465, which establish guidelines for the reimbursement of expenses by issuers to NYSE member organizations for the processing of proxy materials and other issuer communications to security holders whose securities are held in street name.

The proposed rule change was published for comment in Securities Exchange Act Release No. 38058 (Dec. 18, 1996), 61 FR 68082 (Dec. 26, 1996). Thirty-nine comment letters were received on the proposal, which include a letter submitted by the NYSE in response to the Commission's request for comment.[3] On March 7, 1997, the NYSE submitted Amendment No. 1 to the proposed rule change.[4] This order approves, on a one-year pilot basis, the proposed rule change, as amended, and Amendment No. 1 on an accelerated basis.

## II. Background

NYSE member organizations holding securities in street name solicit proxies and deliver communications to and from beneficial owners of securities on behalf of issuers.[5] For this service, issuers reimburse member organizations for out-of-pocket, reasonable clerical, postage and other expenses incurred for a particular distribution. NYSE Rules 451 and 465 provide guidelines for the reimbursement of these expenses.

Since the late 1960's, NYSE member firms increasingly have used an outside contractor for these types of services

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[4] The Commission notes that use of the Forms will supplement, rather than replace, the current forms utilized by members, when effecting an account transfer. NASD Regulation represents that the use of the Forms is necessary because these securities are held in the member's name for the benefit of the investor. Thus, it is necessary to notify the general partner of the ''change in ownership'' when an investor transfers its account to a different member so the general partner may adjust its records accordingly. Telephone conversation between Suzanne E. Rothwell, Dorothy Kennedy, NASD Regulation, and Anthony P. Pecora, Division of Market Regulation, SEC (Mar. 7, 1997).

[5] 15 U.S.C. 78*o*–3.

[6] 17 C.F.R. 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, Secretary, SEC, dated February 10, 1997 (''NYSE Letter'').

[4] See letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Jonathan G. Katz, Secretary, SEC, dated March 5, 1997. In Amendment No. 1, the NYSE changes the proposal to a one-year pilot and represents that, following the 1997 proxy season, a certified public accounting firm will audit the results of the pilot period. The NYSE states that the independent accountant will report to the Commission and the NYSE no later than October 31, 1997. As discussed below, the independent accounting firm must conduct an audit of the results of operations of ADP Investor Communication Services, the division of Automatic Data Processing, Inc. (''ADP'') that performs proxy intermediary services for approximately 200 NYSE member firms.

[5] Street ownership encompasses shares purchased through a broker or bank (referred to as a nominee). The shares are then registered in the name of that nominee, or in the nominee name of a depository such as The Depository Trust Company (''DTC''). According to a recent NYSE analysis, on average, approximately 70 to 80 percent of all outstanding shares are held in street name.

rather than handling proxy processing internally. For example, a firm would contract with a division of Automatic Data Processing, Inc. (''ADP''), ADP Investor Communication Services, the only intermediary offering these services to broker-dealers, for the solicitation of proxy voting instructions and the distribution of reports to shareholders.[6]

In submitting this rule proposal, the Exchange explains that there have been changes in the market since the last review of the reimbursement guidelines in 1986 that prompt the Exchange to reevaluate its current fee reimbursement schedule. First, the Exchange believes that proxy solicitation and report distributions costs have increased since 1986, in large part, because of the general cost increases in the economy. For example, the Exchange notes that the cost of postage has doubled since 1979. The Exchange believes that the brokers pass these costs through to the issuers, directly or through ADP.

Second, the Exchange believes that the aggregate costs also have increased for issuers because there has been a substantial increase in the number of beneficial owners, a result of the increased participation of individual investors in the securities market. The Exchange further notes that the percentage of holdings of securities through institutional investors, mutual funds, pension and savings plans also has increased.[7]

Third, the Exchange believes that, in addition to the changing stock ownership patterns, stock holdings continue to migrate from registered to street or nominee ownership.[8] Currently, street name holdings are concentrated with approximately 1,000 nominees, and the Exchange believes that an efficient infrastructure is necessary to coordinate these nominees and their customers and that service bureaus, as agents of nominees, should build and maintain such systems.

Finally, the Exchange notes that there have been significant technological advances in the corporate governance process. For example, nominees and their agents have developed communication systems for obtaining shareholder votes electronically rather than through a physical proxy. To accommodate this development, the Exchange amended its rules to permit telephone voting. The Exchange is concerned, however, that the current fee structure does not recognize the value that some of these systems provide to issuers in reducing the costs of coordination and solicitation. Despite the progress that has been made in the distribution and proxy solicitation process, the Exchange states that the issuers often express their belief that mailing fees are unnecessarily high and that the procedures are not responsive to the needs of the issuers.

In proposing a revised fee reimbursement structure, the Exchange believes that the current fee structure does not provide incentives for nominees and other intermediaries to use the most current and efficient technology. The Exchange believes that without financial incentives, it is unlikely that new cost-reducing technology will be implemented. The Exchange also believes that the current fee structure ignores the economies of scale and costs of coordinating multiple nominees and the value that consolidating material distribution and voting collection provides to issuers.[9]

## III. Description of Proposal

The Exchange proposes to reduce the suggested rate of reimbursement from $.60 or $.70 to $.55 for each set of proxy materials, *i.e.*, proxy statement, form of proxy and annual report, when mailed as a unit. The Exchange proposes to eliminate the current distinction between proposals that require beneficial owner instructions and those that do not. The Exchange believes that this change will produce substantial savings for all issuers.

The Exchange also proposes to reduce the rate for mailing other reports from $.20 to $.15. The rate of reminder notices would remain at $.40 unless a proxy fight is involved. The Exchange proposes to eliminate the special fee of $.60 for mailing only to shareholders who have not voted.

For mailings involving proxy fights, the Exchange proposes to include a new fee of $1.00 for each set of proxy materials mailed. The Exchange believes that proxy contests require significant efforts by all participants in the proxy process and can occur under difficult circumstances.

The Exchange also proposes to implement a new $20 fee per nominee (applicable to each proxy solicitation) to compensate an intermediary for coordinating a series of functions across a multitude of nominees. These services include:

- *Searches:* Rule 14a–13 under the Act requires an issuer to inquire of each record holder to determine the number of beneficial owners holding shares through nominees. Issuers would only incur the expense of performing one ''search'' for all the nominees if an intermediary coordinates multiple nominees.
- *Search responses:* Nominees must respond to an issuer's search request within seven business days of receipt. An intermediary can consolidate responses where there are multiple levels of entities and save administrative expenses for issuers.
- *Delivering materials:* Providing material to hundreds of nominees requires an issuer to sort and ship a parcel to each nominee. An intermediary can reduce the cost to issuers if it can make one material delivery for hundreds of nominees.
- *Use of bulk mail:* If intermediaries combine nominees, issuers could qualify for bulk discounts.
- *Preliminary voting information:* To help issuers determine whether they have a quorum, many brokers currently report a discretionary vote 10 or 15 days before a meeting in accordance with NYSE Rule 451(b)(1), and again at the time of the meeting. For example, ADP sends daily consolidated vote reports 15 or 10 days before a meeting, and then every business day until the night before the meeting. Issuers may save certain expenses if issuers obtain the vote from a single source for hundreds of nominees.

The Exchange believes that the coordination fee is consistent with current Exchange rules that authorize the payment of a coordination fee for agents that coordinate providing information regarding non-objecting

[6] The identity of the soliciting broker remains on all communications.

[7] According to the Exchange, these institutions have an obligation, or, in some cases, a statutory duty, to vote the shares being held and that institutions have developed mechanisms to vote their shares in conformity with their own internal policies and governing regulations. The Exchange believes that many institutional investors have difficulty voting on a timely basis during the spring proxy season where over 40% of all annual meetings occur within a few weeks and some large institutions vote close to the meeting date, particularly during the proxy season because of the increase in paperwork.

[8] ''Nominees'' are those names that appear on either the list of record shareholders or on an omnibus proxy sent to the issuer on the record date by a depository, but who are, in fact, acting for someone else. In practice, they are self-clearing brokers, banks, or other financial institutions participating in DTC or some other depository.

[9] These services, which are not expressly required by any regulation, include: (i) Sending a single search card for multiple nominees; (ii) coordinating multiple nominees to generate a single material request for each issuer; (iii) delivering material to a single place for multiple nominees; (iv) sorting bulk mail across multiple nominees for maximum discounts; (v) daily reporting of votes for multiple broker and bank nominees; and (vi) consolidating multiple nominees into a single invoice. As discussed *infra* note 111, however, the NYSE has indicated that the voting-related services described in the preceding textual paragraph—electronic and telephonic voting services now offered by member firms and/or ADP acting as their agent—will not be covered by the new fee structure.

beneficial owners (''NOBOs'').[10] The Exchange estimates that the smallest 4,000 U.S. issuers would pay, on average, an intermediary nominee coordination fee of $800, which partially would be offset by the lower basic rate and lower expenses.

The Exchange also proposes to clarify the policy with respect to out-of-pocket expenses by providing for reimbursement only of actual costs, such as outgoing postage (plus third class sorting fee), envelopes and business reply envelopes, and custom printing of envelopes and ballots. The exchange proposes that the business reply postage would be billed at the Business Mailing Accounting System (''BRMAS'') rate. The Exchange believes that additional savings are possible by sorting mail to obtain postal discounts as well as through other efforts undertaken by nominees or their agents to reduce issuers' postage expenses, which could be shared between the issuer and the processor.

The Exchange also is proposing a new incentive fee to compensate member organizations and/or intermediaries for eliminating the need to send materials in paper form. The Exchange believes that this fee will encourage member organizations to apply technology to sort materials so that multiple proxy instruction forms are included in a single envelope with a single set of materials to be mailed to the same household. The Exchange is encouraging ''householding,'' whereby the member firm or intermediary could earn the paper elimination fee by distributing multiple proxy instruction forms electronically or by distributing all material to a household electronically. Therefore, the Exchange is proposing a fee of $.50 ($.10 for a quarterly report) for each set of material that is not mailed.

Finally, the Exchange clarifies the manner in which the fees are collected. The Exchange notes that ADP is the agent for many of the brokerage firms that are Exchange members, and that these firms subcontract the data processing functions of the proxy solicitation process to ADP but retain all the obligations to comply with the relevant Exchange rules as well as the Commission's proxy rules (*e.g.*, Rule 14b–1). ADP has developed a ''single invoice'' procedure for all brokers with whom they have subcontracted to avoid issuers having to pay multiple brokers. Under this procedure, ADP bills issuers on behalf of brokers and banks and remits to their clients the amounts specified in their contracts, which the firms will retain to cover their own costs. The Exchange believes that this billing procedure does not affect issuer costs. If the broker billed issuers directly, the issuers would pay the same amount but to several brokers rather than to a central data processor. The Exchange believes that there is no economic difference in the brokerage firms retaining part of the costs paid by the issuers or such firms receiving the same amount paid by ADP through the single invoice system and that issuers benefit from this procedure because they are able to pay a single processor rather than multiple brokerage firms.

The Exchange proposes the new fee structure for a one-year pilot term. Following the 1997 proxy season, the NYSE proposes that a certified public accounting firm audit the results of the pilot period by examining the costs and experiences of the issuers, NYSE member organizations and intermediaries during the pilot. The Commission expects this audit to encompass ADP's results of operations for the one-year pilot period. The independent accountant will present a written report detailing the methodology and results of its audit to the Commission and the NYSE, respectively, no later than October 31, 1997 so that appropriate changes, if necessary, may be made for a second pilot.

## IV. Summary of Comments

The Commission received a total of 38 comment letters on the NYSE's proposal.[11] The NYSE also submitted a letter in response to the comments requested by the Commission.[12] A substantial majority of the letters

[10] See NYSE Rule 451.92.

[11] See letters from William A. Bowen, Vice-President, Finance, AAON, Inc., to Margaret H. McFarland, Deputy Secretary, SEC, dated January 30, 1997 (''AAON Letter''); John D. Quinn, Vice President, A.G. Edwards & Sons, Inc., to Margaret H. McFarland, Deputy Secretary, SEC, dated February 5, 1997 (''A.G. Edwards Letter''); Patricia A. Bell, Second Vice President, Shareholder Services, AFLAC Incorporated, to Secretary, SEC, dated February 6, 1997 (''AFLAC Letter''); Sarah A. Miller, Senior Government Relations Counsel, Trust and Securities, American Bankers Association, to Jonathan G. Katz, Secretary, SEC, dated February 21, 1997 (''ABA Letter''); Sari L. Macrie, Vice President, Investor Relations Ameritech, to Secretary, SEC, dated January 31, 1997 (''Ameritech Letter''); Brian T. Borders, President, Association of Publicly Traded Companies, to Jonathan G. Katz, Secretary, SEC, dated February 10, 1997 (''APTC Letter''); Carol A. Gasson, Senior Financial Analyst, Apollo Group, Inc., to Margaret H. McFarland, SEC, dated January 15, 1997 (''Apollo Letter''); Carl T. Hagberg, Cart T. Hagberg and Associates, to Secretary, dated February 11, 1997 (''Hagberg Letter''); John Finegan, Chief Financial Officer, Cornerstone Imaging, Inc., to Richard Grasso, Chairman and Chief Executive Officer, NYSE, dated September 11, 1996 (''Cornerstone Letter''); James T. Huffman, President, Credo Petroleum Corporation, to Secretary, SEC, dated February 7, 1997 (''Credo Letter''); Gordon G. Garney, President, Corporate Transfer Agents Association, Inc. to Secretary, SEC, dated February 3, 1997 (''CTA Letter''); Thomas E. Ross, Manager, Shareholder Relations Department, DQE, to Secretary, SEC, dated February 5, 1997 (''DQE Letter''); H. John Sauer III, Principal/Operations, Edward Jones, to SEC, dated January 15, 1997 (''Edward Jones Letter''); Glynn E. Williams, Jr., Vice President, Finance, Goodrich Petroleum Corporation, to Margaret McFarland, Deputy Secretary, SEC, dated January 17, 1997 (''Goodrich Letter''); James P. Owens, V.P. Finance, Gradco (USA) Inc., to Margaret McFarland, Deputy Secretary, SEC, dated January 14, 1997 (''Gradco Letter''); David S. Ruksznis, Director, Shareholder Operations and Securities Services, GTE Service Corporation, to SEC, dated February 3, 1997 (''GTE Letter''); James R. Klucharits, Controller, Isomedix Inc., to Secretary, SEC, dated January 15, 1997 (''Isomedix Letter''); Rene Vanguestaine, Managing Director, JP Morgan, to Jonathan G. Katz, Secretary, SEC, dated February 14, 1997 (''JP Morgan Letter''); Nancie W. LaDuke, Vice President, Secretary, Kmart Corporation, to SEC, dated February 6, 1997 (''Kmart Letter''); Robert Donovan, Senior Vice President, Legg Mason Wood Walker, Incorporated, to Secretary, SEC, dated January 31, 1997 (''Legg Mason Letter''); Sophia G. Vergas, Assistant Secretary, The Liberty Corporation, to Secretary, SEC, dated February 6, 1997 (''Liberty Letter''); Rhonda Anderson, Director, Corporate Secretary's Department, Lucent Technologies, to Secretary, SEC, dated February 10, 1997 (''Lucent Letter''); Martin J. McDermott, Senior Assistant Secretary, Merck & Co., Inc., to Jonathan G. Katz, Secretary, SEC, dated February 11, 1997 (''Merck Letter''); Gordon G. Garney, Senior Assistant Secretary, Mobil Corporation, to Secretary, SEC, dated February 6, 1997 (''Mobil Letter); John T. Wall, Executive Vice President, The Nasdaq Stock Market, Inc., to Jonathan G. Katz, Secretary, SEC, dated March 13, 1997 (''Nasdaq Letter''); Kathryn G. Casparian, Managing Director, Oppenheimer & Co., Inc., to SEC, dated January 29, 1997 (''Oppenheimer Letter''); John Howell Bullion, Chief Executive Officer, Orphan Medical, to Secretary, SEC, dated January 14, 1997 (''Orphan Medical Letter''); Nancy R. Kyle, Director, Investor Relations, PepBoys, to Secretary, SEC, dated February 7, 1997 (''PepBoys Letter''); Faye Widenmann, Vice President, Corporate Relations & Administration and Secretary, Pinnacle West Capital Corporation, to Jonathan G. Katz, Secretary, SEC, dated February 5, 1997 (''Pinnacle West Letter''); Patrick J. Callans, Corporate Counsel, Price Costco, Secretary, SEC, dated February 11, 1997 (''Price Costco Letter''); Donna Dabney, Secretary and Assistant General Counsel, Reynolds Metals Company, to Jonathan G. Katz, Secretary, SEC, dated February 7, 1997 (''Reynolds Metals Letter''); Donald D. Kittell, Executive Vice President, Securities Industry Association, to Jonathan G. Katz, Secretary, SEC, dated February 10, 1997 (''SIA Letter''); Jerome J. Clair, Senior Vice President, Smith Barney, to Margaret H. McFarland, Deputy Secretary, SEC, dated February 5, 1997 (''Smith Barney Letter''); George M. Holston, Assistant General Manager and Assistant Secretary, Texaco Inc., to Jonathan G. Katz, Secretary, SEC, dated February 6, 1997 (''Texaco Letter''); Robert J. Agnich, Senior Vice President, Secretary and General Counsel, Texas Instruments Incorporated, to Secretary, SEC, dated January 31, 1997 (''Texas Instruments Letter''); James T. Anderson, Vice President and Treasurer, US West, to Arthur Levitt, Chairman, SEC, dated February 5, 1997 (''US West Letter''); Jennifer LaGrow, Manager, Shareholder Services, the Walt Disney Company, to Secretary, SEC, dated January 17, 1997 (''Walt Disney Letter''); John W. Hetherington, Vice President and Corporate Secretary, Westvaco, to Secretary, SEC, dated February 7, 1997 (''Westvaco Letter'').

[12] See NYSE Letter, *supra* note 3.

support the proposal, [13] although several commenters do not support the proposal.[14] Some commenters support the proposal overall, but express concern about one or two aspects of the proposal.[15]

Most of the commenters express general support for the NYSE's proposed rule change. Many commenters believe that the proposal would provide incentives to the industry to continue to explore and develop new technologies that would help issuers achieve greater economies while improving communications with the shareholders.[16] Several commenters believe that the proposed rule change should improve the timeliness, accuracy and participation rate of proxy tabulation for the issuer.[17] Two commenters believe that the application of advanced technology will result in decreased costs to all corporate issuers, both large and small, and better service for all investors.[18]

Moreover, several commenters argue that the proposed fees are fair and equitable to all parties.[19] One commenter believes that, although the proposed fee structure represents a departure from the original concept of ''reimbursement,'' the proposed fee structure represents a step in the right direction to establish fees that are truly more representative of actual costs.[20] Two commenters support the proposed fee structure although the new fee structure may increase its fees.[21]

One commenter also believes that the proposed fee structure is consistent with the obligations of issuers to reimburse brokers for processing proxy and other materials.[22] In its comment letter, the NYSE reiterates that the proposed fee structure is consistent with the obligations of issuers to reimburse brokers for processing proxy and other materials.[23] The NYSE explains that the proposed fees resulted from consultations with listed companies, member firms and other industry organizations involved in the proxy solicitation process and that the proposal contains compromises intended to address the interests and concerns of all participants.[24]

Several commenters express general concern about the proposed fee structure. Several commenters question why costs to distribute proxy materials to street accounts remain significantly higher than to registered owners.[25] One commenter also argues that advancing technology should reduce, not increase, servicing costs, and that the increasing level of beneficial ownership should reduce, not increase, per unit servicing costs.[26] Moreover, this commenter believes that the brokerage houses should pay the majority of the servicing cost of beneficial ownership because they encourage and derive the major benefit from beneficial ownership.[27]

One commenter argues that at least one study shows that the proposed fee structure will increase proxy mailing costs from 20% to 30%, with no recognizable offsetting benefit.[28] Another commenter notes that the proposal would increase its costs by over 450%.[29] One commenter argues that the proposed fees are higher than what an issuer would pay in a ''free market environment.''[30]

One commenter believes that the NYSE should ensure that the proxy fees offer only reimbursement of costs to the nominees.[31] This commenter believes that the nominees have some obligation to enhance and improve the proxy process, whether they perform the proxy solicitation process in house or through an intermediary.[32] The commenter argues that the NYSE should encourage the free market to develop and implement new technologies by allowing individual issuers to choose whether to take advantage of a new process or procedure and to make their own decisions based on internal cost/benefit analysis.[33]

Several commenters address specific aspects of the NYSE's rule proposal. Two commenters support the reduction of the suggested rate of reimbursement to $.55 for each set of proxy materials when mailed as a unit.[34] Specifically, one commenter notes that the reduced rate would still be sufficient for the broker-dealers to handle all of the functions relating to proxy materials.[35] Another commenter, however, is not convinced that $.55 is the right number for enclosing and tabulating proxy materials and notes that it pays a much lower fee to vendors for its registered accounts.[36]

Several commenters endorse the recommendation that actual cost for all out-of-pocket expenses be passed along to the issuers and that issuers share in postage discounts.[37] One commenter believes that all out-of-pocket expenses should be passed along to the issuers at cost.[38] One commenter suggests that all postal discounts should be passed on to the issuers.[39] Another commenter suggests that there be an annual review of out-of-pocket expenses.[40]

Several commenters specifically address the proposed $.50 incentive fee.

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[13] See AAON Letter, A.G. Edwards Letter, ABA Letter, Ameritech Letter, Apollo Letter, Cornerstone Letter, CTA Letter, Edward Jones Letter, Goodrich Letter, Gradco Letter, GTE Letter, Isomedix Letter, Kmart Letter, Legg Mason Letter, Liberty Letter, Merck Letter, Mobil Letter, Oppenheimer Letter, Orphan Medical Letter, PepBoys Letter, Price Costco Letter, Smith Barney Letter, Texaco Letter, Texas Instruments Letter, US West Letter, Walt Disney Letter, Westvaco Letter, *supra* note 11. See also APTC Letter (not opposing proposal as pilot program and recognizing it as a necessary first step toward improving upon the effectiveness and the efficiency of the overall issuer/shareholder communication system), SIA Letter (supporting the reimbursement fees, nominee fee and householding fee because they are the result of open and extensive negotiations between issuer representatives and broker dealers that process independently and through an intermediary), *supra* note 11.

[14] See Credo Letter, Hagberg Letter, Pinnacle West Letter, *supra* note 11.

[15] See *e.g.*, ABA Letter, APTC Letter, Lucent Letter, *supra* note 11.

[16] See Apollo Letter, Cornerstone Letter, Goodrich Letter, Isomedix Letter, see also Edward Jones Letter, Gradco Letter, Nasdaq Letter, PepBoys Letter, *supra* note 11.

[17] See Apollo Letter, Cornerstone Letter, Goodrich Letter, Isomedix Letter, *supra* note 11.

[18] See Orphan Medical Letter, Walt Disney Letter, *supra* note 11. Several commenters note a related issue of late proxy voting by pension funds and institutions that arises with the application of new technology in the proxy voting process. These commenters explain that these funds and institutions have used advancements in technology to vote later than before the introduction of these services. See Mobil Letter, Pinnacle West Letter, US West Letter, *supra* note 11.

[19] See Orphan Medical Letter, Walt Disney Letter, *supra* note 11; see also Legg Mason Letter, *supra* note 11.

[20] See Texaco Letter, *supra* note 11.

[21] See Liberty Letter, PepBoys Letter, *supra* note 11.

[22] See Smith Barney Letter, *supra* note 11.

[23] NYSE Letter, *supra* note 3.

[24] See NYSE Letter, *supra* note 3. One commenter agrees with the NYSE that the current fee structure does not recognize the value that service bureaus, such as ADP, provide through their coordinated system of distribution and proxy solicitation and that the proposal would recognize the services provided and upon which many member firms rely. This commenter believes that without an incentive to invest in enhanced technology, service bureaus could not effectively build the infrastructure necessary to support sophisticated applications. See Oppenheimer Letter, *supra* note 11. Another commenter notes that ADP offers services that small issuers use and appreciate although small issuers do not utilize certain sophisticated services because many shareholders lack the equipment and/or sophistication to take advantage of modern technology. See Liberty Letter, *supra* note 11.

[25] See Pinnacle West Letter and US West Letter, *supra* note 11.

[26] See Credo Letter, *supra* note 11.

[27] See Credo Letter, *supra* note 11.

[28] See Pinnacle West Letter, *supra* note 11.

[29] See Credo Letter, *supra* note 11.

[30] See Hagberg Letter, *supra* note 11.

[31] See DQE Letter, *supra* note 11.

[32] See DQE Letter, *supra* note 11.

[33] See DQE Letter, *supra* note 11.

[34] See CTA Letter, Mobil Letter, *supra* note 11.

[35] See CTA Letter, *supra* note 11.

[36] See Lucent Letter, *supra* note 11.

[37] See AAON Letter, Ameritech Letter, Apollo Letter, Cornerstone Letter, Goodrich Letter, Isomedix Letter, *supra* note 11.

[38] See US West Letter, *supra* note 11.

[39] See DQE Letter, *supra* note 11.

[40] See AFLAC Letter, *supra* note 11.

One commenter supports this fee because it would not only help to reduce further the proxy fee, postage, and printing costs for the annual report and proxy statement but also reduce stockholder frustration caused by multiple mailings.[41] Another commenter believes that the proposal would provide an incentive for the elimination of duplicate mailings.[42] One commenter believes that the ''householding'' incentive fee will result in net savings to the company.[43] This commenter believes that the fee should be structured so that mailing list reductions are quantified prior to the print date for annual reports and other proxy materials to maximize the potential savings to issuers.[44]

One commenter, however, questions how issuers would determine the savings realized by using the householding process and whether householding would cause a further delaying getting the vote to the issuer.[45] Another commenter argues that the NYSE should require that all recordkeepers minimize the number of duplicate mailings or should ensure that any consolidation fee permitted is based on direct cost savings to issuers, payable only in the first year of savings, and shared between the issuers and the intermediary.[46]

One commenter believes that the paper and postage elimination fees are significantly higher than what most transfer agents charge for these same services and that it would be appropriate to pass these charges on to issuers only if the fees are market driven and comparable to what other companies in the marketplace are charging for similar activity.[47] Another commenter believes that any fee paid to a broker for assistance in eliminating duplicate mailings should be based on actual reasonable costs incurred by the broker.[48] One commenter also notes that the proposed incentive fee would increase fees for foreign issuers with a relatively small U.S. float.[49]

Several commenters address the $20 per nominee fee. One commenter believes that the per nominee fee is fair compensation for the services of an intermediary and would provide the proper incentives to focus on technology initiatives that will save the issuer community additional money in the long term.[50] In its comment letter, the NYSE further explains that the nominee coordination fee represents reimbursement for coordination costs incurred by ADP and that the fee is a reasonable attempt to provide compensation for new services being offered under the current proxy solicitation process.[51] Moreover, the NYSE believes that coordination of nominees reduces costs for issuers.[52]

Two commenters request a description of services included in the $20 per nominee fee.[53] Specifically, one commenter believes that such a breakdown would help the issuers determine if the amounts charged for the fees are justified and comparable to free-market costs.[54] Another commenter believes that the $20 nominee fee should be followed by establishing new rules to govern the various services handled by intermediaries.[55] Two commenters express concern about the impact of the proposed new nominee fee on small issuers.[56] Specifically, one commenter suggests that the NYSE and the Commission review the market data during the pilot period to ensure that small issuers are not being disadvantaged unfairly under the proposed fee structure.[57]

Several commenters object to the $20 nominee fee because it would increase the costs of transmitting proxy materials even though no new or additional services would be provided.[58] One commenter notes that the proposed structure unduly penalizes smaller companies that do not have large institutional share concentrations but have numerous nominees who represent only a few beneficial owners.[59] One commenter suggests that a progressive nominee service fee based on the number of shareholder accounts would be more equitable.[60] Another commenter argues that before a per nominee fee can be considered, there must be an independent way to confirm the number of nominees associated with an issuer.[61]

Several commenters address the Commission's request for comment on what should be deemed as ''reasonable expenses'' under the Commission's proxy rules. Some commenters believe that reasonable expenses should include an intermediary's cost to coordinate an issuer's proxy mailing to multiple nominees and the expenses of operating an electronic proxy voting system.[62] One commenter, however, believes that only member organizations or intermediaries that perform extra functions relating to coordinating the mailing and voting of proxy material to multiple nominee accounts should be entitled to receive fair and reasonable compensation for their associated efforts.[63] Another commenter believes that the ''[c]osts to develop and operate an electronic proxy voting system, which appears to be designed primarily to facilitate ADP and the institutions and not the industry as whole, should not be passed along to issuers.'' [64] One commenter believes the definition of reasonable expenses should include actual out-of-pocket expenses and not represent a profit item for the broker-dealers, banks and nominees.[65]

With respect to the Commission's request for comment on whether the determination of ''reasonableness'' should vary with the size of the issuer, one commenter believes that the determination of reasonableness should not vary based on issuer size or any other criteria.[66] Two commenters support varying reasonable fees with the size of the issuer.[67] Specifically, one believes that a tiered pricing structure that properly recognizes the true

[41] See Texas instruments Letter, *supra* note 11.

[42] See Westvaco Letter, *supra* note 11.

[43] See Reynolds Metal Letter, *supra* note 11.

[44] See Reynolds Metal Letter, *supra* note 11.

[45] See Pinnacle West Letter, *supra* note 11.

[46] See DQE Letter, *supra* note 11.

[47] See US West Letter, *supra* note 11. This commenter also disagrees with the NYSE's contention that it is impracticable to develop reimbursement guidelines that vary based on the size of one's mailing because this method is standard procedure in a number of industries.

[48] See GTE Letter, *supra* note 11.

[49] See JP Morgan Letter, *supra* note 11. This commenter argues that the NYSE should amend its rules to exempt non-U.S. issuers from NYSE's proxy requirements.

[50] See Legg Mason Letter, *supra* note 11.

[51] See NYSE Letter, *supra* note 3. The Commission notes, again, that the NYSE has indicated that the costs of electronic and/or telephonic voting will not be passed through to issuers under the new fee structure. See *supra* note 9; *infra* note 111.

[52] See NYSE Letter, *supra* note 3.

[53] See AFLAC Letter, CTA Letter, *supra* note 11.

[54] See CTA Letter, *supra* note 11.

[55] See Mobil Letter, *supra* note 11.

[56] See ABA Letter and Nasdaq Letter, *supra* note 11.

[57] See ABA Letter, *supra* note 11.

[58] See DOE Letter, Reynolds Metal Letter and Pinnacle West Letter, *supra* note 11.

[59] See Credo Letter, *supra* note 11.

One commenter expresses concern that the proposed nominee fee would increase fees for foreign issuers with relatively small U.S. float. See JP Morgan Letter, *supra* note 11. This commenter argues that the NYSE should amend its rules to exempt non-U.S. issuers from NYSE's proxy requirements.

[60] See Reynolds Metal Letter, *supra* note 11.

[61] See DOE Letter, *supra* note 11.

[62] See CTA Letter, Mobil Letter, Smith Barney Letter, US West Letter (commenting only on coordinating an issuer's proxy mailing to multiple nominees), *supra* note 11.

[63] See Texaco Letter, *supra* note 11.

[64] See US West Letter, *supra* note 11.

[65] See Mobil Letter, *supra* note 11.

[66] See Smith Barney Letter, *supra* note 11.

[67] See Hagberg Letter, Lucent Letter, *supra* note 11.

economies of scale would be appropriate.[68]

In its comment letter, the NYSE explains that the NYSE Committee on Shareholder Communications has not been able to reach a consensus on tiering because of the different service requirements of companies of different sizes.[69] To illustrate, the NYSE explains that, although large issuers may believe that they subsidize smaller issuers, larger issuers drive more of the cost of infrastructure such as vote processing.[70]

Several commenters address whether the reasonableness determination should take into account any fee sharing arrangements between an intermediary and its broker-dealer clients. Several commenters argue that reasonable expenses should not include reimbursement to subsidize revenue sharing or a rebate system.[71] Moreover, several of these commenters believe that revenue sharing and rebates artificially inflate expenses charged to issuers and create an unnecessary barrier to entry for competition in the business.[72] One commenter argues that the rebates available only to a single, dominant provider have made it impossible for new providers who might otherwise be able to offer lower fees or money saving technologies to enter the business.[73]

Another commenter states that issuers have no way of knowing how much of their fees are actually being rebated to member organizations and that rebates should be only made to cover a broker's actual costs.[74] One commenter questions why revenue sharing occurs.[75] Another commenter believes that the rebate process should be fully investigated to determine if it is in the best interests of the capital markets and is consistent with the goal of free and fair competition.[76]

One commenter explicitly supports the fee sharing arrangement between broker-dealers and intermediaries as appropriate within the fee structure.[77] This commenter notes that when a broker-dealer outsources to an intermediary, it does not typically outsource 100% of the activities covered by the fees.[78] The commenter believes that the amount of the fee sharing should be determined by negotiation between each broker-dealer and its intermediary.[79]

A few broker-dealer commenters also explain that nominee does not eliminate all costs by outsourcing their proxy mailings.[80] These commenters note certain costs that nominees must bear as it: (1) Continues to maintain proxy personnel in its office to answer broker and customer questions as well as to handle the operational aspects of balancing positions and voting totals; (2) transmits data each day to and from ADP; (3) writes and maintains programs to support and enhance the transmission and continue to do so; and (4) has other overhead and administrative costs.[81] The NYSE agrees with these commenters that broker-dealers continue to incur some costs in the proxy solicitation process and that it would be reasonable that the fees issuers pay be split between the intermediary and the broker-dealer.[82] During the pilot, such costs would be identified more fully and assessed by the independent accounting firm.

Several commenters support the formation of an industry committee to evaluate the effectiveness of the proposal during the pilot period.[83] Moreover, one commenter suggests that unresolved issues can be addressed by an industry committee during the pilot period.[84] One commenter suggests that if a pilot program is implemented, the intermediary should be required to send two invoices to customers over the pilot period, with one under the old billing arrangement and one under the new.[85]

Several commenters address the issue of whether an independent audit during the pilot period would be helpful in assessing the reasonableness of the costs passed through to issuers. Most of these commenters support an independent audit.[86] One commenter suggests that to be truly meaningful, the independent audit should include all reasonable costs incurred by the issuers, broker-dealers, ADP, and nominees in mailing proxy material to beneficial holders and the processing of votes back to the issuer's vote tabulator.[87] Another commenter believes that auditing of actual cost of material such as envelopes will lead to even more savings and make it easier for stockholders to register their votes.[88] Two commenters suggest that profit sharing arrangements should be audited to determine the reasonableness of these costs.[89]

Other commenters believe that the expense of an independent audit is not necessary.[90] Specifically, one commenter believes that there should be some definite reason to believe that an independent audit is worth the expense.[91] The NYSE also believes that, although an audit would be useful in determining whether member firms and intermediaries accurately implemented the new fees and for some elements of the costs to be tested in an audit, an audit would not be useful to determine the ''right'' fee.[92]

With regard to the Commission's request for comment on whether the proposed NYSE nominee fee and incentive fee should be deemed to apply to reimbursement by non-NYSE issuers to NYSE member firms, two commenters believe that the new fee structure should apply to all issuers and not be limited to NYSE listed companies.[93] Specifically, one believes that these fees should apply to all issuers because the covered activities are the same for all issuers, regardless of the listing.[94] Two commenters argue that the fees should apply to all domestic corporations when dealing with NYSE members.[95] The NYSE agrees with these commenters in that limiting fees to NYSE issuers would result in confusion and an increase of expenditure of scarce resources to duplicate efforts.[96]

One commenter, however, believes that the proposed NYSE nominee fee and incentive fees should not necessarily apply to non-NYSE issuers because the non-NYSE issuers should be permitted to negotiate lower proxy fees from other stock exchanges.[97]

## V. Discussion

The Commission finds that the proposed rule change is consistent with

[68] See Hagberg Letter, *supra* note 11.

[69] See NYSE Letter, *supra* note 3.

[70] See NYSE Letter, *supra* note 3.

[71] See CTA Letter, GTE Letter, Lucent Letter, Mobil Letter, Smith Barney Letter, US West Letter, *supra* note 11.

[72] See CTA Letter, GTE Letter, Mobil Letter, US West Letter, *supra* note 11.

[73] See Hagberg Letter, *supra* note 11.

[74] See Texaco Letter, *supra* note 11.

[75] See AFLAC Letter, *supra* note 11.

[76] See DOE Letter, *supra* note 11.

[77] See SIA Letter, *supra* note 11.

[78] See SIA Letter, *supra* note 11.

[79] See SIA Letter, *supra* note 11.

[80] See A.G. Edwards Letter, Legg Mason Letter, Oppenheimer Letter, *supra* note 11.

[81] See A.G. Edwards Letter, Legg Mason Letter, *supra* note 11.

[82] See NYSE Letter, *supra* note 3.

[83] See Apollo Letter, Cornerstone Letter, Goodrich Letter, GTE Letter, Isomedix Letter, *supra* note 11.

[84] See CTA Letter, *supra* note 11.

[85] See DQE Letter, *supra* note 11.

[86] See CTA Letter, Lucent Letter, Mobil Letter, Orphan Medical Letter, Reynolds Metal Letter, Texaco Letter, US West Letter, Walt Disney Letter, *supra* note 11.

[87] See CTA Letter, *supra* note 11.

[88] See Texas Instruments Letter, *supra* note 11.

[89] See Mobil Letter, Texaco Letter, *supra* note 11.

[90] See A.G. Edwards Letter, Legg Mason Letter, Smith Barney Letter, *supra* note 11.

[91] See A.G. Edwards Letter, *supra* note 11.

[92] See NYSE Letter, *supra* note 3.

[93] See SIA Letter, Smith Barney Letter, *supra* note 11.

[94] See SIA Letter, *supra* note 11.

[95] See A.G. Edwards Letter, Legg Mason Letter, *supra* note 11.

[96] See NYSE Letter, *supra* note 3.

[97] See Texaco Letter, *supra* note 11.

the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b).[98] Section 6(b)(4) requires that exchange rules provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using the facilities of an exchange.[99] Section 6(b)(5) requires, among other things, that exchange rules promote just and equitable principles of trade and that they are not designed to permit unfair discrimination between issuers, brokers or dealers.[100] Section 6(b)(8) prohibits any exchange rule from imposing any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.[101] Based on the record adduced by the NYSE, the Commission believes that the fees under the proposed reimbursement schedule are reasonable and fairly allocated, do not discriminate among issuers, and do not impose any unnecessary burdens on competition. The Commission will re-evaluate this preliminary determination in light of the results of the pilot program and the independent accounting firm's report.

The Commission believes that the NYSE's proposal to amend the suggested rate of reimbursement for the distribution of materials and to impose certain incentive and nominee fees are consistent with the Act because the proposal reflects changes in the market, such as advances in technology and increases in distribution costs, and changes in the corporate governance process since the last update of the fee reimbursement schedule in 1986. The Commission also believes that the proposed fee reimbursement structure should promote the application of advanced technology to the shareholder communication process and is a reasonable accommodation of the interests of various market participants involved in the proxy solicitation process. A majority of the commenters also support the proposal, believing that it would provide the industry with incentives to continue to develop new technologies that would help issuers reduce costs while improving communications with shareholders.

Moreover, the proposal also reduces the basic rates of reimbursement for the first time since the adoption of the rules. The proposal reduces the fees for mailing each set of proxy materials from $.60 or $.70 to $.55 and reduces the rate for mailing other reports from $.20 to $.15. The Commission believes that these reductions should produce substantial savings for issuers.

The NYSE has examined the cost increases of its issuers under the proposed fee structure and believes that, in general, most of the issuers would receive a cost reduction with this proposal. There may be some increases for small issuers, but the new nominee cost may be partially offset by the lower basic rates and lower expenses. Moreover, there may be other costs savings, particularly ''out-of-pocket savings,'' and the new incentive fees may result in fewer mailings, decreasing printing and mailing costs.[102]

The Commission believes that the new reimbursement schedule is the result of the NYSE's careful balancing of interests of issuers and broker-dealers. The Commission has, nevertheless, determined to approve the NYSE's proposed fee structure on a one-year pilot basis to allow the Exchange and the Commission to review the progress and effect of the fee structure. The Commission believes that the experience with the proposed fee structure during the one-year pilot period would be valuable to the NYSE and to the Commission in determining whether any modifications are necessary. The Commission notes that the NYSE has committed to an independent audit, at the conclusion of the 1997 proxy season, of the new fee structure to assess the reasonableness of the costs passed through to issuers with a report of the findings made to the Commission.[103]

*A. Commenters' Concerns*

AS discussed above, the NYSE is proposing to adopt two new fees for the first time—the nominee fee and the automation incentive fee. These fees are different from the other mailing reimbursement fees set forth in the NYSE rules in that they are related costs other than actual mailing costs. As a result, several commenters express specific concern about these fees.

Several commenters also express general concern that the proposed fee structure may increase costs to issuers. The Commission believes that, although in certain instances costs to issuers may increase under the proposed fee structure, the reduction of mailing fees and the design of the structure to encourage savings in the long term should be beneficial to all market participants.

One commenter argues that the proposed fees are higher than what an issuer would pay in a ''free market'' environment.[104] The Commission notes that, in adopting the direct shareholder communications rules, it left the determination of reasonable costs to the self-regulatory organizations (''SROs'') because, as representatives of both issuers and brokers, the SROs were deemed to be in the best position to make a fair evaluation and allocation of the costs associated with the distribution of shareholder materials. The Commission believes that, at this time, it is appropriate for the NYSE to propose the amount for each fee in the fee reimbursement structure, with the Commission reviewing the fee schedule to ensure its compliance with the standards of the Act. As discussed below, however, the Commission encourages the NYSE and the issuer and broker-dealer communities to initiate dialogue so that competition may play a greater role in this process.

Another commenter argues that NYSE's fee schedule should offer only reimbursement of costs to the nominees and that the NYSE should encourage a free market to develop and implement new technologies by allowing individual issuers to choose whether to take advantage of a new process or procedure.[105] The Commission believes, however, that because the current fee schedule only provides for reimbursement of costs, service providers do not have any incentive to develop and implement new technologies. As discussed in more detail below, the Commission believes that certain incentive fees are necessary to encourage these service providers to develop cost effective methods of distributing shareholder materials.

[98] 15 U.S.C. 78f(b).

[99] 15 U.S.C. 78f(b)(4).

[100] In approving these rules, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[101] 15 U.S.C. 78f(b)(8).

[102] The NYSE conducted an analysis of the proposed fee reimbursement structure on several small issuers based on the figures from the 1996 proxy season. For example, for one small issuer, although the proxy costs under the proposed fee structure would increase by $2,766, this issuer could realize savings in the range of $630 to $2,520 by suppressing proxy mailings by householding, which could offset the increase in proxy costs.

[103] Although several commenters support the formation of an industry committee to evaluate the proposal over the pilot period, the Commission believes that an independent audit would better alleviate concerns of market participants with varying interests regarding the reasonableness of the proposed fee structure in relation to the services provided.

The NYSE has represented to the Commission that the report of the independent accountant will be provided to the Commission and the NYSE no later than October 31, 1997. The Commission will review the report to determine whether any change would be appropriate for the 1998 proxy season.

[104] See Hagbert Letter, *supra* note 11.

[105] See DQE Letter, *supra* note 11.

1. Nominee Fee

As discussed above, the NYSE proposes a new $10 nominee fee for intermediaries that provide coordination for a series of functions across a multitude of nominees. Several commenters object to the nominee fee because it may increase costs to smaller issuers. The NYSE represents that the fee is intended to be reimbursement for coordination costs incurred by intermediaries and that the fee is a reasonable attempt to provide compensation for services that are being currently offered. Moreover, the NYSE believes that coordination by nominees should reduce costs for issuers.

The Commission has considered the NYSE's representations as to the effect of the new ''nominee fee'' of $20 per nominee for their potential impact on issuers. The Commission recognizes that, although these fees may have a greater impact on small issuers than large and mid-sized issuers, the combined effect of the reduced rates of reimbursement for mailing proxy and other materials along with the imposition of these new fees could result in greater benefit to all issuers in general, depending, of course, on the results of the pilot. Based on the information provided by the NYSE and the supportive comment letters, the Commission believes—subject, again, to the results of the pilot—that the nominee fee would appear to constitute reasonable compensation for the services provided by an intermediary that could produce savings for issuers in the long term. The Exchange estimates that the smallest U.S. issuers would pay, on average, an intermediary nominee fee of $800. This is a relatively small sum and is designed to compensate for the services provided by the intermediary.

The Commission also believes that the new fees will provide incentives for intermediaries to develop technologically innovative ways to communicate with issuers and to lower costs overall. Although these fees may have relatively greater impact on small issuers, the new fee structure reflects economies of scale and may more accurately reflect the actual distribution and proxy solicitation costs. Moreover, the Commission believes that these fees, by encouraging the use of technology for shareholder communications, could help to promote further improvement of the corporate governance process.

Commenters also express concern about whether any new or additional services are being provided by an intermediary for the $20 nominee fee and ask, in any case, whether such services are being provided at free-market cost. First, the Commission notes that the NYSE has provided a list of coordinating functions that would qualify a nominee for the reimbursement of the $20 fee. Any intermediary that coordinates these functions for multiple nominees would be entitled to the fee. Although ADP is the only intermediary currently offering these services to broker-dealers, there is nothing in the NYSE proposal that would restrict the payment of this fee to another entity providing similar services and thus the rule is not anti-competitive in application.

Second, the Commission notes that an intermediary coordinating multiple nominees could result in reduced costs to issuers in printing, posting and administrative costs.[106] Although this has not been quantified specifically by the NYSE in its rule proposal, during the one-year pilot, the Exchange and the Commission can review the results of the pilot program, including but not limited to the independent accounting firm's report, to ensure that no issuers are unfairly disadvantaged under the proposed fee structure, and that the nominee fee is a reasonable expense incurred to distribute proxy and other shareholder material. At the conclusion of the pilot, if necessary, the Exchange can propose further modifications to the fee structure to avoid any unintended adverse effects.

2. Automation Incentive Fee

The NYSE proposes a new incentive fee to compensate member organizations for eliminating materials in paper form (*i.e.*, additional fee of $.50 ($.10 for a quarterly report) for each set of material that is not mailed). One commenter believes that incentive fees should be based on actual reasonable costs incurred by the broker for eliminating duplicate mailings.[107] Another believes that the incentive fees should be passed on to issuers only if the fees are market driven and comparable to what other companies in the marketplace are charging for similar activity.[108]

The Exchange has represented to the Commission that the householding fee is intended to encourage members firms to apply technology to distribute materials electronically. The Commission believes that, if the incentive fee only reimburses the cost of eliminating the duplicate mailings, nominees would have no incentive to provide these services because nominees would be reimbursed for their costs regardless of whether they provide these types of services. Moreover, the Commission notes that the fee would produce the unquantifiable benefit of reducing shareholder frustration and confusion by eliminating duplicate mailings to shareholders.

One commenter expresses concern that the proposed incentive fee as well as the nominee fee would increase fees for foreign issuers with a relatively small U.S. float and argues that the NYSE should amend its rules to exempt non-U.S. issuers from NYSE's proxy requirements.[109] The Exchange states, and the Commission agrees, that in this context there are no compelling reasons to treat non-U.S. issuers and U.S. companies differently. Although non-U.S. issuers are exempt from most of the Commission's proxy rules pursuant to Rule 3a12–3 under the Act, non-U.S. issuers generally do provide U.S. shareholders with proxy and related information and seek votes of their U.S. holders. The Exchange, therefore, states that broker-dealers and other intermediaries face the same reimbursement issues with non-U.S. companies as they do with U.S. companies.

Finally, the Commission notes that the independent audit should help to assess whether the householding incentive fee has had the intended effect of eliminating duplicate mailings and is providing cost savings to issuers.

*B. Reasonableness Determination*

The Commission also requested comments on what should be deemed ''reasonable expenses'' within the meaning of the Commission's proxy rules. As summarized above, the Commission received a variety of responses to this issue. Among them are that reasonable expenses should include an intermediary's cost to coordinate an issuer's proxy mailing to multiple nominees,[110] an intermediary's expense of operating an electronic proxy voting system,[111] and actual out-of-pocket expenses that do not represent a profit

[106] See NYSE Letter, *supra* note 3.

[107] See GTE Letter, *supra* note 11.

[108] See US West Letter, *supra* note 11.

[109] See JP Morgan Letter, *supra* note 11.

[110] See Mobil Letter, Smith Barney Letter, US West Letter, *supra* note 11.

[111] See Mobil Letter, Smith Barney Letter, *supra* note 11.

Another commenter believes that the costs to develop and operate an electronic proxy voting system should not be passed along to issuers because the electronic system appears to be designed primarily to facilitate ADP and the institutions. See US West Letter, *supra* note 11. See also *supra* note 64 and accompanying text. In response, the NYSE states that it has not been led to believe that the fees should cover such a system and, therefore, such costs are not included in the proposal. See NYSE Letter, *supra* note 3. See also *supra* notes 9 and 51.

item for the broker-dealers, banks and nominees.[112]

Finally, in response to the issue of fee sharing arrangements between brokers and intermediaries, several commenters believe that reasonable expenses should not include such arrangements because revenue sharing and rebates artificially inflate expenses charged to issuers and create an unnecessary barrier to entry for competition in the business.[113] At least one commenter, however, believes that fee sharing arrangements are appropriate because when a broker-dealer outsources to an intermediary, it does not typically outsource 100% of the activities covered by the fees.[114]

Although the Commission has carefully considered these comments regarding ''reasonable expenses,'' it has reached no final resolution of the issues noted by commenters. Rule 14a–13(a)(5) requires issuers to reimburse broker-dealers, banks, and other nominees for the reasonable expenses they incur in mailing proxy soliciting materials and annual reports to beneficial holders of such issuers' voting securities. As noted by the NYSE, the fee structure that surrounded the development of the reimbursement of such fees was devised prior to the use of intermediaries by many broker-dealers. In addition, the current fee structure does not recognize the benefits from enabling more shareholder communications to be received through the technological advances made over the past decade. The one-year pilot and the audit that will cover the results of ADP's operations for this period should provide the NYSE and the Commission with the information necessary to determine whether the fee structure needs to be further revised. The Commission will continue to consider the comments during the one-year pilot period and reevaluate these comments before approving a permanent fee schedule.

Finally, with regard to whether the proposed NYSE nominee fee and incentive fee should be deemed to apply to reimbursement by non-NYSE issuers to NYSE firms, the Commission believes that it is preferable that the new fees apply to reimbursement by NYSE issuers to NYSE member firms. At the same time, as the NYSE has noted, member firms, non-member firms and banks historically have used the NYSE guidelines for all mailings, which provide uniformity in the industry. The Commission, however, believes that the reimbursement structure apply to member firms and not to issuers and Section 19(b) does not provide the NYSE with the authority to enforce the reimbursement of these fees on issuers that are not listed on the NYSE and do not use its facilities. This approach is consistent with Section 6(b)(4) of the Act, which allows an exchange to adopt equitable fees for its members, issuers, and other persons using its facilities.

In determining to approve the NYSE's proposal for a one-year pilot period, the Commission has had to assess whether the proposal provides for the equitable allocation of fees among issuers consistent with Section 6(b)(4) of the Act, as well as ensure that it is consistent with Sections 6(b)(5) and 6(b)(8) of the Act by not unfairly discriminating among issuers and imposing a burden on competition that is not necessary under the Act.

As noted above, the proposal has raised a number of concerns about whether the effect of the new fee structure would unduly increase the costs to small issuers and whether both the nominee and householding incentive fees are related to the reasonable expenses of mailing proxy soliciting materials. Although the Commission recognizes that the quantitative material submitted by NYSE to support its proposal is not conclusive on this issue, we believe that that NYSE has made a reasonable case that the fee changes taken together could have a beneficial effect on the costs for mailing proxy material for many issuers. Moreover, to the extent that the nominee fee and household incentive fee encourage the use of new technologies for the electronic distribution of proxy materials, overall mailing costs of issuers could be reduced. As a result, although the Commission recognizes that some issuers may, in the short run, experience an increase in costs, on balance, the Commission believes that the overall effect of the changes may be positive and provide some cost savings.

In conclusion, the Commission believes that the proposal to amend the suggested rate of reimbursement for the distribution of materials and to impose certain new fees is consistent with the Section 6(b)(4) requirement that exchange rules provide for the equitable allocation of fees among its members and issuers. The proposed fee structure appears to provide for reasonable fees and does not appear to discriminate between issuers, brokers or dealers in contravention of Section 6(b)(5). Moreover, the Commission believes that the proposed reimbursement schedule does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act as required by Section 6(b)(8).

The pilot period and independent audit should help the Commission assess whether the potential benefits of the fee structure change do, in fact, have a positive effect overall on the proxy fee reimbursement structure. Indeed, during this period, the Commission encourages the Exchange, issuers, and member firms to consider a long term solution to determining reasonable expenses in connection with broker-dealers' mailing of proxy soliciting materials and annual reports to beneficial holders. In doing so, the Commission notes that in adopting the direct shareholder communications rules in the early 1980s the Commission left the determination of reasonable costs to the SROs, because they were deemed to be in the best position to make fair evaluation and allocations of costs associated with these rules. The Commission believes that ultimately market competition should determine ''reasonable expenses'' and recommends that issuers, broker-dealers and the NYSE develop an approach that may foster competition in this area. Rather than having the rates of reimbursement set by the SROs, the Commission suggests that the NYSE and other SROs explore whether reimbursement can be set by market forces, and whether this would provide a more efficient, competitive, and fair process than SRO standards.

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof. This amendment merely changes the length of the pilot from three years to one year. Based on the above, the Commission finds that there is good cause, consistent with Section 6(b)(5) of the Act, to accelerate approval of Amendment No. 1.

## VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

[112] See Mobil Letter, *supra* note 11.

[113] See CTA Letter, GTE Letter, Mobil Letter, US West Letter, *supra* note 11.

[114] See SIA Letter, *supra* note 11. The NYSE also agrees

Several broker-dealer commenters also explain that a nominee does not eliminate all costs by outsourcing their proxy mailings. See *supra* note 80 and accompanying text. The NYSE also agrees with these commenters. See NYSE Letter, *supra* note 3.

change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–NYSE–96–36 and should be submitted by April 14, 1997.

**VII. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Sections 6(b)(4), 6(b)(5), and 6(b)(8) and the rules and regulations thereunder.

*It is therefore ordered,* pursuant to section 19(b)(2) of the Act,[115] that the proposed rule change (SR–NYSE–96–36) is approved on a pilot basis ending May 13, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[116]

**Jonathan G. Katz,**

*Secretary.*

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**[Release No. 34–38410; File No. SR–OCC–96–18]**

**Self-Regulatory Organizations: The Option Clearing Corporation Order Granting Approval of a Proposed Rule Change To Revise Rules To Include Limited Cross-Guarantee Agreement**

March 17, 1997.

On December 9, 1996, The Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') a proposed rule change (File No. SR–OCC–96–18) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] Notice of the proposal was published in the **Federal Register** on January 28, 1997.[2] No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

**I. Description**

The rule change revises OCC's by-laws and rules to authorize OCC to execute ''Limited cross-guarantee agreements'' with other clearing agencies. A limited cross-guarantee agreement is an agreement between two or more clearing agencies that provides that if the parties to the agreement must liquidate the assets of an entity that is a member of two or more of the agencies (''common member'') and at least one of the clearing agencies liquidates the assets of the common member in its control to a loss and at least one liquidates the assets of the common member to a gain, each clearing agency liquidating to a gain will make the excess assets of the common member in its control available to each clearing agency liquidating to a loss up to the amount of the loss. If all of the parties to a limited cross-guarantee agreement liquidate the assets of a common member in their respective control to a gain or if all liquidate to a loss, the agreement provides that no assets will be made available by any party to the agreement to any other party. The cross-guaranties established in a limited cross-guarantee agreement are limited in the sense that each part to the agreement guarantees funds to the other parties only if it liquidates the assets of a common member in its control to a net gain and only up to the amount of the net gain.

The effect of a limited cross-guarantee agreement is to enable each part to the agreement to have recourse to the assets of a defaulting common member in the control of the other parties to the agreement. Therefore, a limited cross-guarantee agreement should reduce the risk of each of the clearing agencies which is a party to such an agreement because a defaulting common member may have positions spread across markets in such a manner that its net asset position at one clearing agency is positive even though its net asset position at another clearing agency is negative.

OCC is currently pursuing discussion of the terms of a limited cross-guarantee agreement with other clearing agencies. OCC anticipates that it will be filing with the Commission one or more limited cross-guarantee agreements to which it has become a party following the conclusion of those discussions.

The Commission has generally stated its support of the use of limited cross-guarantee agreements as a mean of reducing the exposure of clearing agencies to loss as a result of the default of common members.[3]

As part of its rules revision to provide for limited cross-guarantee agreements, OCC will add definitions of ''common member,'' ''cross guarantee party,'' and ''limited cross-guarantee agreement'' to Article I of its by-laws. OCC will add new paragraph (i) to Section 5 of Article VIII of its by-laws to provide explicitly that OCC may use the clearing fund contributions of a clearing member to satisfy its limited cross-guarantee obligations to other clearing agencies with respect to that clearing member. New paragraph (i) provides that the amount charged against a clearing member's contributions to the stock clearing fund and non-equity securities clearing fund will be in proportion to the clearing member's contributions to the stock clearing fund and the non-equity securities clearing fund as fixed at the time of the suspension of the clearing member. New paragraph (i) does not provide OCC with any authority to use the clearing fund contributions of other clearing members (*i.e.*, other than the defaulting clearing member) to satisfy any limited cross-guarantee obligation that OCC has to another clearing agency because OCC will not have any obligation pursuant to a limited cross-guarantee agreement which could require recourse to the clearing fund contributions of other clearing members.

OCC also will add new paragraph (j) to Section 5 of Article VIII of its by-laws to establish a rule for allocating funds received by OCC pursuant to a limited cross-guarantee agreement where OCC has charged, or will charge, the stock clearing fund and the non-equity securities clearing fund. The new paragraph provides that the funds will be credited to the stock clearing fund and the non-equity securities clearing fund in proportion to the computed contributions of the suspended clearing member to the two clearing funds as fixed at the time of the suspension of the clearing member. If one of the two clearing funds is made whole then the remainder of the funds will be credited entirely to the other clearing fund.

OCC will add three new interpretations to Article VIII, Section 5 of its by-laws. New interpretation .03 states explicitly that if OCC has a deficiency after the application of all available funds of a suspended clearing member and if OCC cannot determine

[115] 15 U.S.C. 78s(b)(2).

[116] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] Securities Exchange Act Release No. 38188 (January 21, 1997), 62 FR 4089.

[3] Securities Exchange Act Release No. 37616 (August 28, 1996), 61 FR 46887 [File Nos. SR–MBSCC–96–02, SR–GSCC–96–03, and SR–ISCC–96–04] (order approving proposed rule changes seeking authority to enter into limited cross-guaranty agreements).