

available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of GSCC. All submissions should refer to File No. SR-GSCC-2001-15 and should be submitted by April 22, 2002.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁹ that the proposed rule change (File No. SR-GSCC-2001-15) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45644; File No. SR-NYSE-2001-53]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Its Rules Regarding the Transmission of Proxy and Other Shareholder Communication Material and the Proxy Reimbursement Guidelines Set Forth In Those Rules, and Requesting Permanent Approval of the Amended Proxy Reimbursement Guidelines

March 25, 2002.

I. Introduction

On December 21, 2001, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with 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 the NYSE's proxy fee schedule guidelines under its current pilot program, and to seek permanent approval of the pilot program. On January 9, 2002, the NYSE filed Amendment No. 1 to the proposed rule change.³ The proposed rule change and Amendment No. 1 were published in

the **Federal Register** on January 16, 2002.⁴ Eight comments were received on the proposed rule change, as amended.⁵ The NYSE responded to the comments on March 5, 2002.⁶ This order approves the proposed rule change, as amended.

II. Background

NYSE member organizations that hold securities for beneficial owners in street name⁷ solicit proxies from, and deliver proxy and issuer communication materials to, beneficial owners on behalf of NYSE issuers. For this service, issuers reimburse NYSE member organizations for out-of-pocket, reasonable clerical, postage and other expenses incurred for a particular distribution, pursuant to guidelines for reimbursement of these expenses as set forth in NYSE Rules 451 and 465, and Paragraph 402.10(A) of the NYSE's *Listed Company Manual*, (collectively "Rules").⁸

⁴ See Securities Exchange Act Release No. 45263 (January 9, 2002), 67 FR 2264.

⁵ See letters from Paul Conn, Executive Vice President, Computershare Limited, and Steven Rothblum, President, Computershare Investor Services (US), to Secretary, Commission, dated February 6, 2002 ("Computershare Letter"); Rachel E. Kosmal, Senior Attorney, Intel Corporation, D. Craig Nordlund, Senior Vice President, General Counsel and Secretary, Agilent Technologies, Inc., and Keith Dolliver, Senior Attorney, Microsoft Corporation, to Secretary, Commission, dated February 6, 2002 ("Intel et al. Letter"); Keith G. Berkheimer, President, CTA, to Secretary, Commission, dated February 6, 2002 ("CTA Letter"); Carl T. Hagberg to Secretary, Commission, dated February 4, 2002 ("Hagberg Letter"); David W. Smith, American Society of Corporate Secretaries ("ASCS"), to Jonathan G. Katz, Secretary, Commission, dated February 7, 2002 ("ASCS Letter"); Peter C. Suhr, Executive Vice President, Alamo Direct, to Secretary, Commission, dated February 1, 2002 ("Alamo Direct Letter"); Elva Gonzalez, Corporate Manager, Shareowner Services, SBC Communications, to *rule-comments@sec.gov*, Commission, dated February 8, 2002 ("SBC Communications Letter"); and Sarah A.B. Teslik, Executive Director, Council of Institutional Investors ("CII"), to Secretary, Commission, dated February 7, 2002 ("CII Letter") (collectively, "Letters").

⁶ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Sharon Lawson, Senior Special Counsel, Division, Commission, dated March 4, 2002 (responding to the comment letters received regarding the proposed rule change) ("NYSE Response Letter").

⁷ The ownership of shares in street name means that a shareholder, or "beneficial owner," has purchased shares through a broker-dealer or bank, also known as a "nominee." In contrast to direct ownership, where shares are directly registered in the name of the shareholder, shares held in street name are registered in the name of the nominee, or in the nominee name of a depository, such as the Depository Trust Company.

⁸ The Commission's proxy rules, Rules 14a-13, 14b-1, and 14b-2 under the Act, impose obligations on companies and nominees to ensure that beneficial owners receive proxy materials and are given the opportunity to vote. These rules require companies to send their proxy materials to nominees, *i.e.*, broker-dealers or banks that hold securities in street name, for forwarding to beneficial owners. Under these rules, companies must pay nominees for reasonable expenses, both

Since the late 1960s, NYSE member firms increasingly have outsourced their proxy delivery obligations to contractors rather than handling proxy processing internally. According to the NYSE, the primary reason for this shift was that member firms believed proxy distribution was not a core broker-dealer business and that capital could be better used elsewhere. Since 1993, Automatic Data Processing, Inc. ("ADP") has distributed close to 100 percent of all proxies sent to beneficial owners holding shares in street name.⁹

On March 14, 1997, the Commission approved an NYSE proposal that significantly revised the NYSE reimbursement guidelines set forth in the NYSE Rules and established a pilot fee structure ("Pilot Program" or "Pilot").¹⁰ Under the Pilot Program, the NYSE established guidelines for the amounts that NYSE issuers should reimburse member organizations for the distribution of proxy materials and other issuer communications to security holders whose securities are held in street name. The Pilot Program was designed to address many of the functional and technological changes that had occurred in the proxy distribution process since the NYSE Rules were last revised in 1986. The fee structure under the Pilot Program reduced certain fees, increased the fee for proxy fights, and created several new fees.¹¹ The Pilot Program was originally

direct and indirect, incurred in providing proxy information to beneficial owners. The Commission's rules do not specify the fees that nominees can charge issuers for proxy distribution; rather, they state that issuers must reimburse the nominees for "reasonable expenses" incurred.

In adopting the direct shareholder communications rules in the early 1980s, the Commission left the determination of reasonable costs to the self-regulatory organizations ("SROs") because they were deemed to be in the best position to make fair evaluations and allocations of costs associated with these rules. In 1997, during the initiation of the pilot on proxy fee reimbursement, *see infra* note 10, the Commission believed that ultimately market competition should determine "reasonable expenses" and recommended that issuers, broker-dealers, and the NYSE develop an approach that may foster competition in this area. Rather than having rates of reimbursement set by the SROs, the Commission suggested 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.

⁹ ADP is the primary distributor of proxy distribution services for a large majority of broker-dealers and collects fees from issuers based on the NYSE's Pilot Program.

¹⁰ See Securities Exchange Act Release No. 38406 (March 14, 1997), 62 FR 13922 (March 24, 1997) (File No. SR-NYSE-96-36) ("Original Pilot Program").

¹¹ For a more detailed description of the background and history of the proxy distribution industry, proxy fees, as well as events leading to the NYSE's proposal to revise the NYSE Rules and Guideline governing reimbursement of proxy fees, *see* the Original Pilot Program, *supra* note 10.

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 17 CFR 200.30-3(a)(12).

¹¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Darla C. Stuckey, Corporate Secretary, NYSE, to Sharon Lawson, Senior Special Counsel, Division of Market Regulation ("Division"), Commission, dated January 7, 2002 ("Amendment No. 1"). In Amendment No. 1, the Exchange made some technical and clarifying corrections to the proposed rule change.

set to expire on May 13, 1998; however, pursuant to Commission extensions of its initial approval, the Pilot Program has remained in effect since then with some slight modifications.¹²

III. Description of the Proposed Rule Change

The NYSE's current pilot fee structure, incorporated in the NYSE's Rules and guidelines pursuant to the Pilot Program,¹³ is set to expire on April 1, 2002.¹⁴ In this proposed rule change,

industry, proxy fees, as well as events leading to the NYSE's proposal to revise the NYSE Rules and Guideline governing reimbursement of proxy fees, see the Original Pilot Program, *supra* note 10.

¹² See Securities Exchange Act Release Nos. 39672 (February 17, 1998), 63 FR 9275 (February 24, 1998) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through July 31, 1998, and lowering the rate of reimbursement for mailing each set of initial proxies and annual reports from \$.55 to \$.50); 40289 (July 31, 1998), 63 FR 42652 (August 10, 1998) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through October 31, 1998); 40621 (October 30, 1998), 63 FR 60036 (November 6, 1998) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through February 12, 1999); 41044 (February 11, 1999), 64 FR 8422 (February 19, 1999) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through March 15, 1999); 41177 (March 16, 1999), 64 FR 14294 (March 24, 1999) (order extending Pilot Fee Structure through August 31, 1999); 41669 (July 29, 1999), 64 FR 43007 (August 6, 1999) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through November 1, 1999); 42086 (November 1, 1999), 64 FR 60870 (November 8, 1999) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through January 3, 2000); 42304 (December 30, 1999), 65 FR 1212 (January 7, 2000) (notice of filing and immediate effectiveness of proposal extending Pilot Fee Structure through February 15, 2000); 42433 (February 16, 2000), 65 FR 10137 (February 25, 2000) (notice of filing and immediate effectiveness of proposal extending the Pilot Fee Structure through September 1, 2000); 43151 (August 14, 2000), 65 FR 51382 (August 23, 2000) (notice of filing and immediate effectiveness of proposal extending the Pilot Fee Structure through October 10, 2000); 43429 (October 10, 2000), 65 FR 62781 (October 19, 2000) (notice of filing and immediate effectiveness of proposal extending the Pilot Fee Structure through November 20, 2000); 43603 (November 21, 2000), 65 FR 75751 (December 4, 2000) (order extending the Pilot Fee Structure through September 1, 2001, and amending the functions that an intermediary is expected to perform to recover the nominee coordination fee); and 44750 (August 29, 2001), 66 FR 46488 (September 5, 2001) (notice of filing and immediate effectiveness of proposal extending the Pilot Fee Structure through April 1, 2002).

¹³ Supplementary Material .90 to Exchange Rule 451 applies the guidelines to the transmission of proxy materials to shareholders. Supplementary Material .20 to Exchange Rule 465 applies them to the transmission of other materials to shareholders. In addition, Paragraph 402.10(A) of the NYSE's *Listed Company Manual* includes the text of Supplementary Material .90 to Exchange Rule 451 and the Exchange proposes to conform Paragraph 402.10(A) to the changes described below to Exchange Rule 451.

¹⁴ See Securities Exchange Act Release No. 44750 (August 29, 2001), 66 FR 46488 (September 5, 2001) (File No. SR-NYSE-2001-22).

as amended, the Exchange proposes to amend certain reimbursement fees under the Pilot Program and has requested permanent approval. The proposed amendments seek to decrease the basic mailing fees paid by large issuers by 5¢ (from 50¢ to 45¢) and to cut in half (from 50¢ to 25¢) the incentive "suppression" fee that large issuers¹⁵ pay to member organizations that succeed in reducing the number of sets of material that need to be distributed, such as by sending one set of materials to a household holding multiple positions in the issuer's securities.¹⁶

The following sets forth the background that led to the proposed rule change, as provided by the NYSE in its filing.

A. Permanent Approval

Over the last year, the NYSE has participated on the Proxy Voting Review Committee (the "Committee"), a private initiative that was set up to review the proxy process. It includes SROs, representatives of the securities industry, corporate issuers, and institutional investors, as well as ADP, the largest provider of proxy intermediary services. In a letter to Richard Grasso, the Chairman of the Committee stated that the purpose of the Committee was to (i) consider the appropriateness of the current pilot proxy fee schedule, and to (ii) develop a deregulated structure that would allow for broader competition.¹⁷

According to the NYSE, the Committee's experience gained from the Pilot Program convinced the Committee that the guidelines have been instrumental in setting at fair and reasonable levels the costs that issuers incur in having member organizations and intermediaries transmit proxy and other materials to security holders. For that reason, the Committee unanimously voted, with one abstention,¹⁸ to recommend that the NYSE seek permanent approval of the Pilot Program guidelines, as modified by this proposed rule change. As a result, the Exchange filed this proposed rule

¹⁵ The Exchange defines large issuers as issuers whose shares are held in at least 200,000 nominee accounts.

¹⁶ See Supplementary Material .95 ("Householding" of Reports) to Exchange Rule 451 and Supplementary Material .25 ("Householding" of Reports) to Exchange Rule 465.

¹⁷ See letter to Richard A. Grasso, Chairman and Chief Executive Officer, NYSE, from Stephen P. Norman, Chairman, Committee, dated November 28, 2001 (the "Committee Letter"). A copy of the Committee Letter is attached as Exhibit C to the Exchange's proposed rule change.

¹⁸ The National Association of Securities Dealers, Inc., abstained from voting.

change, which incorporates the Committee's recommendations and requests permanent approval of the Pilot Program, which is scheduled to end on April 1, 2002.

B. Guideline Changes

In addition to seeking permanent approval of the Pilot Program guidelines, the Exchange proposes the following amendments to its Rules and guidelines:

(i) Reduce the suggested rate of reimbursement for initial mailings of each set of material (*i.e.*, proxy statement, form of proxy, and annual report when mailed as a unit) from 50¢ to 40¢.

(ii) Increase the suggested per-nominee fee for intermediaries that coordinate the proxy and mailing activities of multiple nominees. The nominee coordination fee is currently \$20 per nominee. The proposal would raise it by 10¢ per set of material required for "Small Issuers," defined as issuers whose shares are held in fewer than 200,000 nominee accounts, or 5¢ per set of material required for "Large Issuers," defined as issuers whose shares are held in at least 200,000 nominee accounts.

(iii) Reduce from 50¢ to 25¢ the incentive fee for initial mailings of the materials of Large Issuers. As a result, the incentive fee for Large Issuers will decrease by 25¢ and the incentive fee for Small Issuers will remain at 50¢.

The Exchange represents that the net effect of clauses (i) and (ii) is to decrease the effective mailing fee by 5¢ for Large Issuers, but not for Small Issuers. ADP projected for the Committee that the combination of that decrease and the decrease in the incentive fee for Large Issuers will decrease the total fees that issuers pay to have materials distributed to shareholders by almost \$11 million.¹⁹ The NYSE relied on this projection to support its proposal.

The NYSE Rules and guidelines currently subject Small Issuers and Large Issuers to the same rates. According to the NYSE, the Committee designed the proposed revamped fee schedule to allocate more fairly the costs of distributing proxy and other material between Large Issuers and Small Issuers. The Committee's, and ultimately the NYSE's, proposal is based on the premise that economies of scale create overall per-account cost savings for Large Issuers and that those savings justify lower fees for Large Issuers. Based on this, the Exchange believes that reducing the rates applicable to Large Issuers relative to the rates

¹⁹ See *supra* note 17.

applicable to Small Issuers is fair, reasonable, and appropriate.²⁰

According to the Exchange, the difference between Large and Small Issuers is based on the recognition that a member organization typically spends less in transmitting material to the nominee account of a Large Issuer than in transmitting material to the nominee account of a Small Issuer because economies of scale apply to many of the tasks of processing material for distribution, and of collecting voting instructions. For instance, the NYSE represents that processing search dates and record dates, logging receipt of materials, coding proxies, reporting voting results, and invoicing fees payable involve costs that are essentially fixed. As a result, the NYSE believes that the per-account cost for these tasks decreases in relation to the number of accounts in which the issuer's shares are held. Consequently, the NYSE believes that the per-account cost is therefore lower with respect to a Large Issuer than with respect to a Small Issuer.

In addition, according to the NYSE, modern data processing and mailing techniques reduce the amount of human intervention involved in the process, driving down the actual per-account cost of handling mailings in large volume. The NYSE notes that the Committee found that the actual cost incurred with respect to Large Issuers in handling mailings was lower than the reimbursable amount that results from adherence to the current NYSE guidelines. On the other hand, the Committee found the actual cost of handling mailings for Small Issuers far exceeded the fees set forth in the current NYSE guidelines.²¹ The Exchange believes that these factors justify reducing the incentive fee from 50¢ to 25¢ for Large Issuers, but not reducing the 50¢ fee for Small Issuers. They also justify the 5¢ difference in the per-set-of-material per-nominee fee for Large Issuers and Small Issuers.

In applying the proposed revamped fee schedules to the NYSE Rules and guidelines, the NYSE decided to establish a line of demarcation that

²⁰ The Committee expressed its support for the proposed fee changes in the Committee Letter. See Exhibit C to the Exchange's proposed rule change.

²¹ The Exchange notes that the Committee found that handling costs for Large Issuers are lower than for Small Issuers, due primarily to economies of scale. The NYSE represents that ADP presented information to the Committee that detailed the costs that issuers pay for registered proxy processing. The Exchange notes that the information provided by ADP indicated that the per-unit costs that Small Issuers pay are, on average, more than 10 times greater than the per-unit costs that Large Issuers pay.

separates Large Issuers from Small Issuers in accordance with the Committee's recommendations. Under the NYSE's proposal, an issuer having 200,000 nominee accounts would qualify as a Large Issuer. As a result, the NYSE believes only the largest issuers, currently fewer than 200 overall, fall within that definition. The NYSE represents that beneficial owners' positions in shares of those Large Issuers account for approximately 50 percent of the number of positions that all beneficial owners maintain in the shares of all issuers. The Exchange therefore adopted the 50 percent mark as an appropriate place at which to draw the line.

The Exchange further states in its proposal that it views the fee-setting process as an ongoing matter. The Exchange represents that even if the Commission grants permanent approval to the proposed fee reductions under the guidelines, the Exchange intends to continue to meet with the Committee to evaluate and fine tune the guidelines and to consider possible approaches to broader reform of the proxy distribution system.

IV. Summary of Comments

The Commission received eight comment letters in response to the propose rule change, as amended,²² the majority of which supported the approval of the proposed rule change.²³ In general, these commenters believed that the proposed fee reductions would give some immediate relief to large issuers. One commenter stated that the proposed fee changes were a good first step.²⁴ Another commenter stated that the proposed rule change should be approved immediately and enacted for the 2002 proxy season.²⁵ Only one commenter stated that the proposed rule change should not be approved on a permanent basis because the proposed fee reductions do not address the issue of competition in the proxy process.²⁶

Several commenters, although urging approval of the current proposal, were critical of the current proxy fee structure, and also raised concerns regarding the need for competition in the proxy distribution system and the issuer's ability to choose service

²² See Letters, *supra* note 5.

²³ See Computershare Letter; Intel *et al.* Letter; CTA Letter; Hagberg Letter; ASCS Letter; SBC Communication Letter; and CII Letter, *supra* note 5. ASCS stated that it is pleased with the proposed fee reduction to the fee sharing agreement between ADP and brokers.

²⁴ See SBC Communications Letter, *supra* note 5.

²⁵ See CTA Letter, *supra* note 5.

²⁶ See Alamo Letter, *supra* note 5.

providers.²⁷ These commenters urged continuing review of the proxy fee structure. Two commenters suggested a review of fees in a deregulated proxy distribution system, stating that prices might be lower if competition and market forces (rather than regulators) determined fees.²⁸ In addition, one commenter, while supporting approval, noted that the guidelines have not been measured against market-based rates, which are significantly lower than those being proposed.²⁹ In addition, one comment letter, jointly sent by three issuers, was critical of the lack of issuer control over service providers for distribution of proxy and other materials to beneficial holders whose shares are held in street name, noting that on the registered side, issuers have the right to choose service providers at a much lower cost.³⁰

Concerns were also raised by three commenters about the composition of the Committee, who noted that not all parties affected by this proposed fee reduction were represented on the Committee.³¹ Some commenters stated that a more independent "formally-sanctioned" committee with official standing and of balanced representation, rather than a private initiative, was needed to further evaluate proxy issues.³² Other commenters wanted to participate on any future committee formed to address other concerns regarding the proxy distribution system.³³

In addition, two commenters addressed the 200,000 nominee accounts cut-off that distinguishes

²⁷ See Computershare Letter; Intel *et al.* Letter; CTA Letter; Hagberg Letter; ASCS Letter; and Alamo Direct Letter, *supra* note 5.

²⁸ See Computershare Letter; and ASCS Letter, *supra* note 5.

²⁹ See Hagberg Letter, *supra* note 5. The Hagberg Letter also stated the NYSE's proposal fails to address the "indirect" income that ADP is collecting by retaining half of the savings in postage from routine bar-coding and sorting procedures. Furthermore, the Hagberg Letter commented that the proposal failed to provide a "sunset provision" for incentive fees, stating that the work involved to eliminate mailings is done once and done automatically through computer programs. Hagberg had previously written a letter to the NYSE in 1996 providing suggestions for a more competitive proxy system (which is attached as Exhibit I to the Hagberg Letter).

³⁰ See Intel *et al.* Letter, *supra* note 5. The Intel *et al.* Letter also stated that the impact of the proposed fee reductions on banks and brokers, which receive a portion of the fees paid by issuers to the service provider, is appropriate.

³¹ See CTA Letter; Hagberg Letter; and Alamo Direct Letter, *supra* note 5. The Alamo Letter stated that ADP was not a "neutral" party and that a third party, not ADP, should have evaluated certain pricing scenarios.

³² See CTA Letter; Hagberg Letter; and ASCS Letter, *supra* note 5.

³³ See Computershare Letter; CTA Letter; and Alamo Direct Letter, *supra* note 5.

between large and small issuers for purposes of the proposed fee reduction, stating that the cut-off was arbitrary and without any factual economic backing.³⁴

One commenter suggested an overall 10¢ reduction from the basic mailing fee rather than a 5¢ reduction for large issuers.³⁵ The commenter also stated that the fees should not be greater than those paid by issuers on the registered side.

Finally, one commenter, while supporting the proposal, urged the Commission to require the NYSE in its ongoing review to obtain and evaluate financial information of the proxy distribution firms and review ADP's fee sharing arrangements with brokers, which suggest the fees may be too generous.³⁶

Separately, certain members of the Committee submitted letters to the NYSE endorsing the Committee's recommendations and proposed fee reductions, as well as permanent approval of the NYSE's Pilot Program.³⁷

V. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.³⁸ In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(4) of the Act,³⁹ which provides that an exchange have rules that provide for the equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities. In addition, the Commission believes that the proposed rule change is consistent with

section 6(b)(5) of the Act,⁴⁰ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest. Furthermore, the Commission believes that the proposed rule change is consistent with section 6(b)(8) of the Act,⁴¹ which prohibits any exchange rule from imposing any burden on competition that is not necessary or appropriate in furtherance of the Act.

The Commission finds that the proposed amendments to NYSE Rules and guidelines governing proxy fees and permanent approval of the amended Pilot Program for the proxy fee reimbursement guidelines should help establish a more practical and organized proxy reimbursement structure. More specifically, the Commission finds that the Committee's recommended fee reductions, as reflected in the NYSE's proposal, are reasonable and should help to alleviate the burden and cost that large issuers currently bear in the proxy distribution process and more fairly allocate the cost among large issuers and small issuers. The Commission notes that the NYSE's proposed fee reductions will result in a decrease in the basic mailing fee from 50¢ to 40¢, an increase in the nominee coordination fee of 10¢ for Small Issuers, as defined by the NYSE above, and 5¢ for Large Issuers, as defined by the NYSE above, and a cut from 50¢ to 25¢ in the incentive/suppression fee that Large Issuers currently pay. Thus, fees for Small Issuers under the proposed rule change are not increased and stay the same, while fees for Large Issuers are reduced overall by 5¢ for the basic mailing fee and by 25¢ for the suppression fee. The NYSE has provided information to show that the cost to service Large Issuers is cheaper than for Small Issuers because of economies of scale. The Commission notes that the differentiation between Large and Small Issuers of 200,000 accounts is based on a 50 percent cut-off, as discussed above, and believes that this is a fair place to draw the line. The Commission therefore believes, as discussed in more detail below, that these proposed fee changes are reasonable and fairly allocated, do not discriminate among issuers, and do not impose any unnecessary burdens on competition.

A. Background

As noted above, since March 1997, NYSE member organizations have charged NYSE issuers proxy reimbursement fees in accordance with a Commission-approved Pilot Program that was recently extended until April 1, 2002.⁴² At the time of adoption of the Original Pilot Program, the Commission received some negative comments regarding the proposed fees, in particular the nominee coordination fee, the incentive fee, as well as the overall impact of the new fee structure on small issuers. While the Commission recognized that the fees could have a greater impact on small issuers than large to mid-sized issuers, the Commission found that the Pilot Program proxy fee structure, which included reduced mailing costs, was, on balance, positive and provided some cost savings. However, because of concerns raised about the impact and reasonableness of the fees and the difficulty in assessing cost savings that might occur as a result of the incentive fee to reduce mailings, among other things, the new proxy fee structure was approved on a pilot basis and the NYSE committed to conduct an independent audit of the pilot fee structure.

Since then, the Pilot Program has been extended numerous times.⁴³ Within this time, NYSE has conducted two audits of the pilot fee structure.⁴⁴ In addition, Commission staff undertook an in-depth review, interviewing numerous proxy industry participants to gather information and views on the proxy system and pilot fee structure.⁴⁵ As a result of these reviews, the Pilot has been modified twice. The first revision was a 5¢ reduction in mailing costs for initial proxies and annual reports.⁴⁶ The second revision amended the Pilot to set forth the minimum services an intermediary must perform in order to receive the nominee coordination fee.⁴⁷

Over the course of the Pilot Program, some issuers, while indicating that they are satisfied with the level of service for the distribution of proxies, have

³⁴ See CTA Letter and Hagberg Letter, *supra* note 5. The CTA Letter further stated that it supported a multi-tiered pricing system and that the fee structure should not only apply to NYSE issuers, but to all issuers.

³⁵ See SBC Communications Letter, *supra* note 5.

³⁶ See CII Letter, *supra* note 5. The CII Letter urged the Commission to require the NYSE to study its pricing structure on a regular basis and to publicly disclose the findings of these regular reviews. See also Intel *et al.* Letter, *supra* note 5.

³⁷ See letter to Richard A. Grasso, Chairman and Chief Executive Officer, NYSE, from Donald D. Kittell, Executive Vice President, SIA, dated November 29, 2001; letter to James E. Buck, Senior Vice President and Secretary, NYSE, from David W. Smith, President, ASCS, dated November 29, 2001; and letter to James E. Buck, Senior Vice President and Secretary, NYSE, from Brian T. Borders, President, APTC, dated November 29, 2001. These letters are included in Exhibit D to the Exchange's proposed rule change and are briefly discussed in the NYSE's proposal. See *supra* note 4.

³⁸ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

³⁹ 15 U.S.C. 78f(b)(4).

⁴⁰ 15 U.S.C. 78f(b)(5).

⁴¹ 15 U.S.C. 78f(b)(8).

⁴² See *supra* note 14.

⁴³ See *supra* note 12.

⁴⁴ See Amendment No. 1, *supra* note 3. See also Securities Exchange Act Release No. 41177 (March 16, 1999), 64 FR 14294 (March 24, 1999), for more detail on the two audits.

⁴⁵ See Securities Exchange Act release No. 41177 (March 16, 1999), 64 FR 14294 (March 24, 1999).

⁴⁶ See Securities Exchange Act Release No. 39672 (February 17, 1998), 63 FR 9275 (February 24, 1998) (lowering the rate of reimbursement for mailing each set of initial proxies and annual reports from the original Pilot fee of \$.55 to \$.50).

⁴⁷ See Securities Exchange Act Release No. 43603 (November 21, 2000), 65 FR 75751 (December 4, 2000).

continued to raise concerns about the fees. Generally, larger issuers have objected to the proxy fee structure because they are not able to enjoy economies of scale, which could result in cost savings to them. These issuers appear to be more inclined to favor a tiered fee structure that could reduce their costs. Smaller issuers, however, could be substantially impacted by a tiered fee structure that could result in increased costs, making it difficult to pay for the proxy process.

During the course of the Pilot Program, the Commission has consistently encouraged the Exchange, issuers, and member firms to consider long-term solutions and to develop an approach that would foster competition so that market forces can determine reasonable rates of reimbursement rather than the NYSE Rules and guidelines. While the Commission today has determined to approve the Pilot Program on a permanent basis, the Commission continues to believe that ultimately market competition should determine reasonable rates and expects the NYSE to continue its ongoing review of the proxy fee process, including considering alternatives to SRO standards that would provide a more efficient, competitive, and fair process. As noted above, the NYSE has indicated its commitment to continue to meet with the Committee to consider broader reforms in this area. The Commission recognizes that the proxy distribution process raises difficult issues, and that the NYSE must balance competing concerns of the issuers who must pay for the proxy distributions and the brokers who must be assured of adequate reimbursement for making such distributions. The Commission believes that permanent approval of the current proxy fee structure will permit the NYSE and other interested parties to focus on a long-term solution that would allow market forces rather than SRO rules to set rates.

B. Specific Comments

As noted above, although the majority of commenters supported the proposal, the comment letters raised specific concerns about the proposed rule change for the pilot fee structure. The Commission believes that the NYSE has adequately responded to the comments.⁴⁸

Commenters raised concerns, for example, over issuers' lack of control over service providers and the higher cost for distribution of proxy and other materials to beneficial holders whose shares are held in street name,

compared to issuers on the registered side, which have the right to choose service providers at a lower cost.⁴⁹ The NYSE stated that, although the proposed fees will be approved on a permanent basis, it views the guideline-setting process as an ongoing matter and will continue to meet with the Committee to evaluate and fine tune the proposed fees under the guidelines. The Commission notes that, over the next year, the Committee, with the NYSE as a member, intends to consider the remaining issues, as raised by the commenters, regarding the need for more competition and to allow issuers the ability to choose among various service providers. The Committee will also consider the possibility of a deregulated proxy distribution system, which would remove the Commission from the rate-making process.

In response to concerns regarding the composition of the Committee, the NYSE stated that it did not select the members comprising the original Committee and indicated that, going forward, the Committee should be both diverse and balanced. The Commission believes that it is important that affected parties be afforded the opportunity to participate in future discussions regarding reformation of the proxy distribution system, and encourages the NYSE to ensure that the Committee has balanced representation.

Furthermore, the NYSE addressed the concerns regarding the use of 200,000 nominee accounts as a cut-off to distinguish between large and small issuers. The NYSE stated that the Committee arrived at the 200,000 figure because issuers with more than 200,000 nominee accounts accounted for approximately 50 percent of the number of positions that all beneficial owners maintain in the shares of all issuers. The NYSE further stated that, although this is an estimation, the Committee unanimously agreed with this 50 percent cut-off. While the Commission recognizes that it is difficult to draw lines, the Commission believes that the NYSE's use of 200,000 nominee accounts as a measure to distinguish between large issuers and small issuers appears reasonable and should more fairly allocate the costs associated with proxy processing and distribution among large and small issuers.

The Commission notes that the Committee, which was comprised of groups representing both large issuers and small issuers, as well as institutional shareholders, unanimously approved (with one abstention) the proposed fee reductions incorporated in

the NYSE's proposal. While the Commission recognizes that some commenters voiced concerns about the composition of the Committee, the Commission believes that the NYSE's proposal is a good first step. As noted above, the NYSE has committed to establish a diversified and balanced Committee as it considers other changes. The Commission is therefore approving these changes to the NYSE Pilot Program so that they are in place by the upcoming 2002 proxy season. In addition, for the reasons stated above, the Commission is approving the Pilot Program on a permanent basis.

C. Summary

In summary, while the Commission has decided to approve the revised proxy fees under the Pilot Program on a permanent basis, the Commission stresses that permanent approval does not end the discussion of proxy fee reform. The main goal is to ensure protection of shareholder voting rights in a competitive marketplace for proxy distribution, where market forces operate freely to set competitive and reasonable rates. The Commission urges the NYSE and the Committee to identify various ways to achieve these goals. As long as the NYSE's proxy fee structure remains in place, the Commission expects the NYSE to periodically review these fees to ensure they are related to "reasonable expenses" of the NYSE's member brokers in accordance with the Act,⁵⁰ and propose changes where appropriate. Such monitoring of fees is essential, especially in light of technological advances such as electronic proxy delivery and voting, which should help to reduce the cost issuers will bear in the future in the proxy distribution process.

VI. Conclusion

For the foregoing reasons, the Commission finds that the NYSE's proposal to amend its Rules and guidelines for proxy fee reimbursement, as amended, is consistent with the requirements of the Act and rules and regulations thereunder. Therefore, the Commission is approving the NYSE's Pilot Program for proxy fee reimbursement, as amended by this proposed rule change, on a permanent basis.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁵¹ that the proposed rule change (SR-NYSE-2001-53), as amended, is approved.

⁴⁸ See *supra* note 8.

⁵¹ 15 U.S.C. 78s(b)(2).

⁴⁸ See NYSE Response Letter, *supra* note 6.

⁴⁹ See Intel *et al.* Letter, *supra* note 5.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵²

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-7781 Filed 3-29-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45641; File No. SR-PCX-2001-48]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. To Increase to Two Hundred Fifty Contracts the Maximum Permissible Number of Equity and Index Option Contracts Executable Through Auto-Ex

March 25, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 27, 2001, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the PCX. The PCX filed Amendment No. 1 on December 5, 2001.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposal on an accelerated basis.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PCX is proposing to increase to 250 contracts the maximum size of equity and index option contracts that may be designated for automatic execution.

Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*; proposed deletions are in brackets.

* * * * *

Automatic Execution System

Rule 6.87(a)-(b)(4)—No change.

(b)(5) The [Options Floor Trading Committee ("OFTC")] *OFTC* shall determine the size of orders that are eligible to be executed on Auto-Ex. Although the order size parameter may be changed on an issue-by-issue basis by the OFTC, the maximum order size for execution through Auto-Ex is as follows:

(A) Equity Options: the maximum order size for execution through Auto-Ex for equity options is [one hundred (100)] 250 contracts;

(B) Index Options: the maximum order size for execution through Auto-Ex is [one hundred (100)] 250 contracts. [for:

- (i) The PSE Technology Index;
- (ii) the Wilshire Small Cap Index; and
- (iii) the Morgan Stanley Emerging Growth Index.]

(6)—No change.

(c)-(p)—No change.

* * * * *

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the PCX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The PCX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange's automatic execution system ("Auto-Ex") automatically executes public customer market and marketable limit orders within certain size parameters. The Exchange represents that Auto-Ex has proven to be a credible system offering prompt and efficient automatic trade executions at the disseminated, quoted prices. PCX Rule 6.87(b) currently provides that the Exchange's Options Floor Trading Committee ("OFTC") shall determine, on an issue-by-issue basis, the size of orders that are eligible to be executed through Auto-Ex. The maximum order size for execution through Auto-Ex is currently 100 contracts for both equity and index options.⁴ The Exchange is

now proposing to increase the maximum size of option orders that are eligible for automatic execution, subject to designation by the OFTC on an issue-by-issue basis, to 250 contracts.

The Exchange believes that increasing the number of option contracts executable through Auto-Ex to 250 contracts will enable the Exchange to more effectively and efficiently manage increased order flow in actively traded option issues consistent with its obligations under the Act. The Exchange believes that this increase will help it to meet the changing needs of customers in the marketplace and give the Exchange better means of competing with other options exchanges for order flow, particularly in multiply traded issues. In addition, the Exchange represents that this increase should bring the speed and efficiency of automated execution to a greater number of retail orders. The Exchange represents that it further believes that its systems capacity is sufficient to accommodate the increased number of automatic executions anticipated to result from implementation of the proposed rule change.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b)⁵ of the Act, in general, and furthers the objectives of section 6(b)(5) of the Act,⁶ in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition and to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will 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

No written comments were solicited or received with respect to the proposed rule change.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written

⁵ 15 U.S.C. 78f(b).

⁶ 15 U.S.C. 78f(b)(5).

⁵² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Mia S. Shiver, Senior Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated December 4, 2001 ("Amendment No. 1"). In Amendment No. 1, the PCX revised the rule text of the proposed rule change to reflect current PCX Rule 6.87.

⁴ See Securities Exchange Act Release No. 43887 (January 25, 2001), 66 FR 8831 (February 2, 2001) (approving PCX proposal to increase the maximum size of index and equity option orders that may be automatically executed through Auto-Ex to 100 contracts).