UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the Petition of: New York Stock Exchange LLC	File No. SR-NYSE-2020-96

PETITION FOR REVIEW OF ORDER DISAPPROVING THE NEW YORK STOCK EXCHANGE LLC'S PROPOSED RULE CHANGE TO AMEND ITS RULES ESTABLISHING MAXIMUM FEE RATES TO BE CHARGED BY MEMBER ORGANIZATIONS FOR FORWARDING PROXY AND OTHER MATERIALS TO BENEFICIAL OWNERS

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The New York Stock Exchange LLC ("NYSE" or the "Exchange") respectfully submits this petition (the "Petition") for review of the order disapproving, pursuant to authority delegated to the Division of Trading and Markets (the "Division"), the Exchange's proposed rule change to delete the maximum fee rates that member organizations may charge securities issuers for forwarding proxy materials and other reports to the beneficial owners of the issuers' stock (the "Disapproval Order").[1]

PRELIMINARY STATEMENT

NYSE proposed amending its rules on proxy reimbursement rates to bring them in line with the Commission's own rules and the rules of every other exchange. Notwithstanding that the Commission has repeatedly approved rules of exchanges in connection with their registration as national securities exchanges and proposed rule changes by other exchanges saying exactly the same thing, the Division by delegated authority disapproved NYSE's proposed amendment. In doing so, the Division improperly held NYSE to a different standard from other exchanges and required NYSE to maintain on its books—at least for now—a reimbursement schedule that market participants broadly agree is outdated and needs updating. The Division attempted to justify its decision based on a hope—unsupported by any Commission requirement or NYSE rule—that NYSE would continue to regulate in the area of proxy fees, even though market participants do not want NYSE to play this role, and the Commission itself previously has expressed a preference for market forces rather than SRO rules to set rates in this space. Because the disparate treatment of exchanges is an important policy issue that should be reviewed by the Commission, and because the Disapproval Order focuses on factors that are invalid under

[1] Order Disapproving a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-92700 (Aug. 18, 2021), 86 FR 47351(Aug. 24, 2021) (the "Disapproval Order").

Section 19 of the Securities Exchange Act of 1934 (the "Exchange Act") and the Administrative Procedure Act, the Commission should grant this Petition and reverse the Disapproval Order.

NYSE's proxy rules currently contain maximum rate schedules for the expense reimbursements that brokers-dealers may charge securities issuers for forwarding their proxy materials and other reports to the beneficial owners of the issuers' shares. These schedules were last updated eight years ago, following a time-consuming and expensive process spearheaded by NYSE, in which all the participants and even the Commission itself questioned the continuing value of NYSE regulation of proxy expense reimbursement rates. NYSE's proposed amendment would have replaced the existing fee schedules with a requirement that the rates charged be "reasonable." This is precisely what the Commission's rules require and what every other exchange's rules already provide. The commenters who expressed a view on NYSE's proposed rule change overwhelmingly supported it. But, the Division, by authority delegated by the Commission, said no.

None of the rationales offered in the Disapproval Order justify treating NYSE differently from other exchanges on the issue of proxy expense reimbursement rates. The principal justifications cited for doing so are NYSE's historical role in regulating proxy fees, and a belief that NYSE is well suited to lead a new, industry-wide, rate-setting process in this area because of its relationships with both issuers and broker-dealers. But NYSE's historical role in setting maximum proxy expense reimbursement rates has been overtaken by the reality that NYSE is no longer better-positioned than other market participants—or even as well-positioned as some of them—to regulate proxy fees. NYSE has no relationship with the mutual funds who generate a substantial percentage of proxy materials, or banks that are required by Commission rule to forward such materials. The vendors with whom banks and brokers contract to forward the

proxies and who actually receive the expense reimbursement payments from issuers are not NYSE members and are not subject to its proxy expense reimbursement rules. While some issuers responsible for paying the expense reimbursement are listed on NYSE, many others are listed on Nasdaq or other exchanges. And unlike FINRA, which counts as its members *all* of the broker-dealers who are required by Commission rules to forward proxy materials, NYSE's membership includes only a subset of those broker-dealers. In short, while NYSE may once have been a convenient forum to bring together all market participants with relevant views on proxy expense reimbursement rates, it no longer plays that role. Nor do market participants even *want* NYSE to regulate proxy fees for the industry. To the contrary, as commenter after commenter told the Commission, they want the *Commission* to get involved and to reform the current proxy expense reimbursement system in a way that both accounts for the views of all stakeholders and ties proxy expense reimbursements to market forces. The Division apparently hoped that, by disapproving NYSE's proposed rule change, the exchange would lead a new rate-setting effort in lieu of such an undertaking by the Commission.

Moreover, because FINRA rules contain essentially the *same* expense reimbursement schedule, NYSE's proposed rule change would have no effect on proxy expense reimbursements in the short run. All broker-dealers would still be subject to the same reimbursement caps. The potential longer-term market impact on which the Division focused—*i.e.*, the consequences of NYSE relinquishing its historical role in maintaining and updating published reimbursement rates—was not a valid basis for disapproving the proposal, including because neither the NYSE rules proposed to be modified nor any other NYSE rule or other requirement obligates NYSE to perform that regulatory function. Thus, the Division's rationale for its disapproval was not tethered to the rule change that NYSE actually proposed, which would simply have de-published

NYSE's reimbursement rate schedule without changing the same restrictions imposed by the FINRA schedule.

The Disapproval Order also improperly holds NYSE to a vague and unknowable standard for amending its rules. The Division asserts that the Commission was not foreclosing the possibility that NYSE could amend its rules in the future to eliminate the expense reimbursement schedule, if NYSE submits additional materials to show that FINRA—a different self-regulatory organization over which NYSE has no control—could adequately take into account issuer interests in setting proxy expense reimbursement rates. But the Division failed to identify what specific additional materials—or even what category of materials—it contemplated NYSE submitting. Reasoned agency action cannot hinge on vague demands for a stronger showing without any guidance about how the regulated entity could ever hope to make that showing.

For all these reasons, and others discussed herein, the Commission should grant NYSE's petition, set aside the Disapproval Order, and approve NYSE's proposed rule change.

BACKGROUND

The NYSE proposed rule changes that are the subject of this Petition concern the maximum expense reimbursement rates that NYSE member organizations may charge for forwarding proxy and other materials received from issuers to the beneficial owners of the issuers' stock. The Exchange Act and Commission rules require issuers to provide proxy materials to their stockholders.[2] Most shares of stock, however, are not directly registered in the name of their beneficial owners. Instead, they are held in "street name," meaning that the shares are registered in the name of a "nominee"—typically a broker-dealer or bank—or in the name of

[2] *See, e.g.*, 15 U.S.C. §§ 78n(a)(1)–(2); 17 C.F.R. § 240.14a-3(a).

a nominee depository, such as the Depository Trust Company.[3] Rules 14b-1 and 14b-2 bridge the gap between issuers and the beneficial owners of their stock by requiring the record holders of the shares—*i.e.*, the nominee broker-dealers and banks—to forward the proxy materials they receive from issuers to the beneficial owners of their stock within five business days of receiving such materials from the issuers.[4] This forwarding requirement is contingent, however, on the broker-dealers and banks receiving the issuers' "assurance of reimbursement of [their] reasonable expenses, both direct and indirect, incurred in connection with" forwarding the proxy materials.[5] Rules 14b-1 and 14b-2 do not specify what it means for expenses to be "reasonable" or attempt to quantify the fees that nominees may charge issuers for proxy distribution.[6]

A. NYSE's Current Proxy Expense Reimbursement Rates and Proposed Rule Change

Consistent with Rule 14b-1, NYSE Rule 451 requires member organizations—including a subset of broker-dealers subject to Rule 14b-1—to transmit all proxy materials they receive from issuers to the beneficial owners, subject to "satisfactory assurance that the [issuer] will reimburse such member organization for all out-of-pocket expenses, including reasonable clerical expenses, incurred by such member organization in connection with such solicitation."[7]

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[3] *See* Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, Release No. 34-70720 (Oct. 18, 2013), 78 FR 63530, 63531 n.14 (Oct. 24, 2013) (order approving NYSE amendments to rules governing proxy expense reimbursement schedule) ("2013 Approval Order"); *see also* Disapproval Order, *supra* note 1, at 2-3.

[4] 17 C.F.R. § 240.14b-1(b)(2); 17 C.F.R. § 240.14b-2(b)(3); *see also* Notice of Filing of Proposed Rule Change Amending its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-90677 (Dec. 15, 2020), 85 FR 83119 (Dec. 21, 2020) (notice of filing of proposed NYSE amendments to rules governing proxy expense reimbursement schedule) ("Notice").

[5] 17 C.F.R. § 240.14b-1(c)(2)(i); 17 C.F.R. § 14b-2(c)(2)(i).

[6] Disapproval Order, *supra* note 1, at 3.

[7] NYSE R. 451(a)(2).

Supplementary material to NYSE Rule 451 goes beyond Rule 14b-1 by setting forth a schedule of approved charges that NYSE has approved "as fair and reasonable rates of reimbursement of member organizations for all out-of-pocket expenses" associated with proxy transmittal pursuant to NYSE Rule 451.[8] The supplementary material further prohibits NYSE member organizations from seeking expense reimbursement at any rate *above* the approved fee schedule.[9] The Commission approved this maximum expense reimbursement schedule in October 2013, and the schedule took effect in 2014.[10]

On December 2, 2020, NYSE submitted a proposed rule change to amend its rules regarding the maximum fees chargeable by NYSE members for forwarding proxies and other materials.[11] NYSE's proposal would have modified NYSE Rules 451.90 to 451.96 (and cross references to those materials) to delete the approved expense reimbursement rate schedule, and instead provide that member organizations may charge only "fair and reasonable rates of reimbursement" and must comply with any schedule of approved charges set forth in the rules of any other exchange or self-regulatory organization of which that entity is a member.[12] As discussed in the Notice and further below, NYSE's proposed rule change would have made its rules consistent with the rules of other exchanges—rules that the Commission has already

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[8] NYSE R. 451.90. Additional fees are authorized for transmitting beneficial ownership information to the issuers. *See* NYSE R. 451.92. *See also generally* Notice, *supra* note 4, at 83119-20.

[9] NYSE R. 451.93. NYSE Rule 465 similarly governs member organizations' obligation to distribute issuer annual and quarterly reports to beneficial owners of the issuers' stock, and cross-references the supplementary material to NYSE Rule 451 as the maximum expense reimbursement for such distribution. *See* NYSE R. 465 & 465.20; Notice, *supra* note 4, at 83120.

[10] NYSE R. 451.96; *see also* 2013 Approval Order, *supra* note 3, at 63531.

[11] Notice, *supra* note 4, at 83119.

[12] *Id.* at 83120.

approved.[13] The proposed rule change also would have reflected the reality that NYSE is no longer specially positioned to set proxy expense reimbursement rates for the securities industry.

B. Changes to the Regulation of Proxy Expense Reimbursement Rates

In the years since the Commission adopted Rules 14b-1 and 14b-2, there have been several significant changes to the process through which nominees forward proxy materials and other reports to the beneficial holders of issuer stock, the manner in which exchanges regulate the reimbursement of associated expenses, and NYSE's role in rate setting in this area.

First, while Rules 14b-1 and 14b-2 place the transmittal obligation on broker-dealers and banks, those entities do not, in practice, forward proxy materials themselves. Rather, as the Commission has recognized, these entities now contract with a small number of third-party vendors to handle the proxy forwarding.[14] These vendors are not members of NYSE or any other exchange, nor are they members of FINRA. Thus, NYSE, the other exchanges, and FINRA do not have direct insight into these vendors' actual costs for transmitting proxy materials to beneficial owners of stock. Nevertheless, these vendors are the ultimate recipients of the expense reimbursements.

Second, with the exception of NYSE and FINRA (which maintains a proxy expense reimbursement rate schedule nearly identical to NYSE's),[15] no exchange or other SRO includes a

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[13] *Id.* at 83119 & n.7.

[14] *See* Disapproval Order, *supra* note 1, at 12-13 n.49. Further, beginning at least as far back as 2000, "[n]early all large broker and many bank intermediaries currently outsource the proxy material distribution function for beneficial security holders to ADP Investor Communication Services." Delivery of Proxy Statements and Information Statements to Households, Release Nos. 33-7912, 34-43487 (Oct. 27, 2000), 65 FR 65736, 65743 (Nov. 2, 2000). The successor to ADP's business in proxy forwarding, Broadridge Financial Solutions, Inc., "handle[d] almost all proxy processing and distribution to beneficial owners holding shares in street name in the United States" as of 2013. 2013 Approval Order, *supra* note 3, at 63531.

[15] *See* FINRA R. 2251.

maximum proxy expense reimbursement schedule in its rules. Rather, the rules of other exchanges simply provide that expense reimbursements must be reasonable, and/or that the members of those exchanges must comply with fee schedules published by other SROs.[16] The Commission has approved such rules pursuant to its authority under Section 19 of the Exchange Act.[17]

Third, the existing expense reimbursement schedule in NYSE's rules no longer reflects NYSE's current position in the competitive landscape among exchanges or any specific core competency of NYSE. The rate schedule is not the product of any recent initiative, but rather is an artifact of NYSE's historical role in this area. As the Commission recognized in its Order Instituting Proceedings for the proposed rule change at issue, NYSE began requiring issuers to reimburse brokers for their reasonable costs in forwarding proxy materials long before the Commission adopted Rules 14b-1 and 14b-2. Indeed, NYSE "has required issuers, as a matter of policy, to reimburse its members for out of pocket costs for forwarding materials" since 1937, and NYSE has published a rate schedule since 1952.[18] As noted above, NYSE adopted the most recent iteration of its rate schedule in 2013.

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[16] *See, e.g.*, BZX Exchange, Inc. R. 13.3; Investors Exchange ("IEX") R. 6.130. Although Nasdaq likewise does not maintain a maximum proxy expense reimbursement schedule, its rules require its members to comply with the guidance of FINRA, which does. *See* The Nasdaq Stock Market, Inc., Gen. R. 9, § 6(b) ("For purposes of this Rule, the guidance adopted by FINRA with respect to reasonable rates of reimbursement as provided in FINRA Rule 2251 and the accompanying supplementary material is hereby adopted as the guidance of the Nasdaq Board.").

[17] *See, e.g.*, In the Matter of the Application of Investors' Exchange, LLC for Registration as a National Securities Exchange, Release No. 34-78101 (June 17, 2016), 81 FR 41142 (June 23, 2016) (approving IEX rule); Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify the Exchange's All-Inclusive Annual Listing Fees for Exchange Traded Products, Release No. 34-87870 (Dec. 30, 2019), 85 FR 391 (Jan. 3, 2020) (approving Nasdaq rule, which adopted FINRA guidance with respect to reasonable rates of reimbursement).

[18] Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member

Historically, NYSE led the industry effort to regulate proxy expense reimbursement rates as a matter of convenience, but not because of any special expertise in this area. Until recently, many of the largest companies by market capitalization listed on NYSE, and the main broker-dealers who held issuer shares in "street name" for their customers were NYSE members.[19] As such, NYSE was once well situated as a forum for determining the actual costs of forwarding proxy materials to beneficial owners of issuer stock, and bringing together the key parties whose views were most relevant to the issue of expense reimbursement rates.

NYSE no longer plays that role and has not done so for some time. Today, a significant percentage of the largest companies list their stocks on other exchanges. Mutual funds, which are responsible for a major portion of the proxies that require forwarding under Rules 14b-1 and 14b-2 are not listed on NYSE.[20] While a subset of the brokers who are nominally responsible for forwarding proxy materials under Rule 14b-1 are members of NYSE, many are not.[21] None of the banks subject to Rule 14b-2 are NYSE members either. Moreover, as discussed above, none of the proxy forwarding vendors who actually do this work in practice are NYSE members. To the extent it ever did, NYSE no longer has any more regulatory authority than any other exchange to require the relevant entities to disclose their actual costs for forwarding proxy materials. Nor does NYSE have any special influence with these industry participants such that

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Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-91359 (Mar. 18, 2021), 86 FR 15734, 15736 n.38 (Mar. 24 2021) ("OIP").

[19] Notice, *supra* note 4, at 83119-20.

[20] *See* Letter from Todd J. May, CEO, Sec. Transfer Assoc., to Secretary, Securities and Exchange Commission (Mar. 1, 2021) at 2 ("STA March 1, 2021 Letter") (noting that when the NYSE historically led proxy expense reimbursement rate setting, "mutual funds were in nascent stages," but now they are "preponderant").

[21] *See* Letter from John Carey, Vice President, NYSE, to Secretary, Securities and Exchange Commission (Apr. 28, 2021) at 2 ("NYSE Letter") ("NYSE's members who engage in retail broker services primarily consist of larger and more established brokers" and "many smaller regional brokers and digital only brokers" are not NYSE members).

it can convene them into a working group to lead a regulatory effort to set new industry-wide expense reimbursement rates for proxy forwarding fees. In sum, NYSE is no better situated than any other SRO to engage in proxy expense reimbursement rate-setting.

The problems with NYSE setting proxy expense reimbursement rates for an entire industry came into clear focus the last two times that NYSE made material changes to its proxy expense reimbursement rules. Through both rounds of regulatory approval, the Commission and commenters increasingly questioned NYSE's role in setting rates. First, in 1997, NYSE established a Pilot Program on proxy reimbursement fees that, through several iterations, resulted in permanent changes to NYSE's rules in 2002. During the 2002 approval process, the Commission received numerous comment letters questioning NYSE's position as a leading organization.[22] Next, in 2010, NYSE convened the Proxy Fee Advisory Committee ("PFAC"), which again worked over the course of multiple years to update the proxy reimbursement rates. The process was very expensive and faced considerable skepticism from the Commission and opposition from commenters when the updated rates were proposed in 2013.[23]

Through both approval processes, the Commission expressed an opinion that "a long-term solution" to proxy distributions should "allow market forces rather than SRO rules to set rates."[24] In 2013, "the Commission emphasize[d] that it [was] continu[ing] to review the issues raised in the [NYSE proposal], including ways to encourage competition in the proxy distribution process, so that more reliance can be placed on market forces to determine

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[22] *See generally* 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, Release No. 34-45644 (Mar. 25, 2002), 67 FR 15440 (Apr. 1, 2002) (the "2002 Order").

[23] *See* 2013 Approval Order, *supra* note 3, at 63531-32.

[24] 2002 Order, *supra* note 22, at 15444; *see also* 2013 Approval Order, *supra* note 3, at 63547.

reasonable rates of reimbursement."[25] In addition, in both approval processes, the Commission expressed its "expectation" that NYSE would "periodically review" its rates for "[a]s long as the NYSE's proxy fee structure remains in place."[26]

Notably, however, there is no statutory or regulatory requirement for NYSE to continually update its proxy expense reimbursement rate schedule. NYSE's own rules do not require it to review its rates or publish new ones. Nor do Commission rules. Instead, NYSE has historically updated its rates on an ad hoc basis as a matter of convention. Given the eight years that have elapsed since the rates were last updated and the sea changes the industry has experienced in that time, the 2013 fees are likely out of date—a view acknowledged by NYSE in its most recent proposed rule change and expressed by many of the commenters who submitted letters.[27] But, for the reasons articulated above, NYSE rules are not the appropriate venue to make those updates.

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[25] 2013 Approval Order, *supra* note 3, at 63547.

[26] *Id.* at 63531-32 (citing 2002 Order).

[27] *See* Notice, *supra* note 4, at 83120; *see also* Letter from Paul Conn, President of Global Capital Markets, Computershare, to Secretary, Securities and Exchange Commission (Jan. 11, 2021) at 4 ("Computershare Letter") ("Although the general expectation in the industry was that the fees would be reviewed every 3-5 years, or whenever there is a significant breakthrough in technology, [but] the last PFAC review was in 2012, with changes to the fees effective 2013."); Letter from Dorothy M. Donohue, Deputy General Counsel, Investment Co. Inst., and Joanne Kane, Senior Director, Investment Co. Inst., to Secretary, Securities and Exchange Commission (Jan. 8, 2021) at 3 ("ICI January 8, 2021 Letter") (highlighting NYSE's suggestion that "[t]he current fee schedule has been in place since 2013 and a comprehensive review of fee levels may be necessary in the near future to respond to the continuing evolution in both technology and the securities ownership patterns of investors since that time"); Letter from Noah Hamman, CEO, Advisorshares, to Secretary, Securities and Exchange Commission (Jan. 14, 2021) at 3 ("Advisorshares Letter") ("We agree [with NYSE] and strongly recommend that the Commission review ICI 2018 Letter, which details recommendations for change....").

C. Procedural History

NYSE first submitted its proposed rule change on December 2, 2020, which the Commission published for public comment on December 15, 2020.[28] On February 1, 2021, the Commission set a longer time to take action on the proposal.[29] On March 18, 2021, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act to determine whether to approve or disapprove the proposed rule change.[30] On June 11, 2021, the Commission designated a longer period for Commission action on the proposed rule change.[31]

1. *Comment Letters*

The Commission received 20 comment letters to NYSE's proposed rule change. A large majority of the commenters supported the proposed rule change.[32] Notably, no commenter

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[28] *See* Notice, *supra* note 4, at 83119.

[29] *See* Notice of Designation of a Longer Period for Commission Action on a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-91025 (Feb. 1, 2021), 86 FR 8420 (Feb. 5, 2021).

[30] OIP, *supra* note 18.

[31] Notice of Designation of a Longer Period for Commission Action on Proceedings To Determine Whether To Approve or Disapprove a Proposed Rule Change To Amend Its Rules Establishing Maximum Fee Rates To Be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-92154 (June 11, 2021), 86 FR 32301 (June 17, 2021).

[32] *See, e.g.*, ICI January 8, 2021 Letter, *supra* note 27; Letter from Peter J. Germain, CLO, Federated Hermes, to Secretary, Securities and Exchange Commission (Jan. 11, 2021); Letter from Heidi Hardin, General Counsel, MFS Investment Management, to Secretary, Securities and Exchange Commission (Jan. 11, 2021) ("MFS January 11, 2021 Letter"); Letter from Basil K. Fox, Jr., President, Franklin Templeton Investor Service, LLC, to Secretary, Securities and Exchange Commission (Jan. 11, 2021); Letter from Catherine L. Newell, General Counsel, Dimensional Fund Advisors LP, to Secretary, Securities and Exchange Commission (Jan. 11, 2021) ("Dimensional Letter"); Letter from Timothy W. McHale, Senior Vice President, Capital Research & Management Co., and Anthony M. Seiffert, CCO, Am. Funds Service Co., to Secretary, Securities and Exchange Commission (Jan. 11, 2021) ("Capital Group January 11, 2021 Letter"); Letter from Thomas E. Faust Jr., CEO, Eaton Vance Corp., to Secretary, Securities and Exchange Commission (Jan. 14, 2021) ("Eaton Vance Letter"); Advisorshares Letter, *supra* note 27; Letter from Joanne Kane, Senior Director, Investment Co. Inst., and Sarah

argued the NYSE's current rate schedule should remain in place without updates. Functionally, all of the comments pertained to the overall mechanism for setting expense reimbursement rates for proxy distribution and expressed the view that the Commission—rather than NYSE or any particular exchange—should take a more active role in regulating in this space. For instance, commenters generally wrote that: (1) the current NYSE-led regime for rate setting is out of date and not functional;[33] (2) the fees themselves and their structure are not reasonable;[34] and (3) the Commission should take bona fide regulatory action on this issue.[35] In fact, as the Division

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A. Bessin, Associate General Counsel, Investment Co. Inst., to Secretary, Securities and Exchange Commission (May 13, 2021) ("ICI May 13, 2021 Letter").

[33] *See, e.g.*, Dimensional Letter, *supra* note 32, at 1 (arguing that the existing framework results in "non-negotiable, non-market-based pricing that has been left in place for years at a time, causing… unnecessarily high costs for fund shareholders"); Capital Group January 11, 2021 Letter, *supra* note 32, at 2 ("[T]he current fee schedule should be modernized…."); Letter from Timothy W. McHale, Senior Vice President & Senior Counsel, Capital Research & Mgmt. Co., to Secretary, Securities and Exchange Commission (May 18, 2021) at 1 ("Capital Group May 18, 2021 Letter") ("[T]he current framework governing the fees for regulatory mailings is outdated and does not reflect the true costs associated with paper and electronic delivery of regulatory documents."); Letter from Todd J. May, President, Sec. Transfer Assoc., to Secretary, Securities and Exchange Commission (Apr. 14, 2021) Letter at 4 (arguing that "the fee-setting process needs to reflect this transition to [electronic delivery] and the efficiencies in operating systems that have resulted").

[34] *See, e.g.*, ICI January 8, 2021 Letter, *supra* note 27, at 2 ("[F]unds pay three to five times as much to distribute materials through intermediaries as they pay when they can distribute materials directly[.]"); Computershare Letter, *supra* note 27, at 2 ("[T]he current structure of proxy reimbursement fees is inappropriate and leads to unfair outcomes for issuers…."); Eaton Vance Letter, *supra* note 32, at 1 ("[T]he current oversight structure serves to perpetuate unnecessarily high costs for shareholders of registered investment companies."); STA March 1, 2021 Letter, *supra* note 20, at 1 (agreeing with the view that the current NYSE-led system as "broken").

[35] *See, e.g.*, ICI January 8, 2021 Letter, *supra* note 27, at 2 ("[The Commission] must take this opportunity to reform the current processing fee system for distributing fund materials."); ICI May 13, 2021 Letter, *supra* note 32, at 2, 4 ("The Commission is the only entity with the authority and broad perspective needed to reform the processing fee framework and determine the standards that should govern these fees."); Letter from Marcia Asquith, Executive Vice President, FINRA, to Secretary, Securities and Exchange Commission (Apr. 14, 2021) at 2 (expressing its view that "the best means to regulate these activities…would be standards—and, if necessary, fee schedules—established directly by the Commission."); Capital Group May 18,

observed, "almost all commenters urged comprehensive, Commission-led reform to the current reimbursement structure."[36] This includes securities issuers, who likewise expressed their preference for a "market-based framework" orchestrated by the Commission, as opposed to continued, ad hoc regulation of proxy fees by NYSE.[37] As one commenter stated, the Commission must create a system that allows for "competition in[] the beneficial shareholder mailing marketplace" to "naturally produce the fairness and equilibrium that has, to the detriment of fund shareholders, been lost over time."[38]

2. *Disapproval Order*

On August 18, 2021, the Division, acting pursuant to delegated authority, issued an order disapproving NYSE's proposed rule change. Specifically, the Division concluded that the Commission did not have information sufficient to determine whether NYSE's proposed rule change was consistent with Section 6(b)(5) of the Exchange Act and "designed to promote just and equitable principles of trade and to protect investors and the public interest, and not []

2021 Letter, *supra* note 33, at 1 ("We believe the Commission is in the best position to implement reforms to the processing fee framework to ensure the fees borne by mutual fund investors are fair and reasonable."); Letter from Heidi Hardin, General Counsel, MFS Investment Mgmt., to Secretary, Securities and Exchange Commission (May 19, 2021) at 1 ("[D]eliberate Commission action in the form of interpretive guidance or rulemaking is the only path forward."); Dimensional Letter, *supra* note 32, at 2 ("[T]he Commission [should] facilitate greater competition by permitting funds (rather than intermediaries) to select who will deliver fund materials on their behalf.").

[36] Disapproval Order, *supra* note 1, at 47355 n.52.

[37] The Shareholder Communications Coalition, which comprises two associations that represent senior executives at more than 1,600 public companies, "urge[d] the SEC to formally begin the process of reforming the proxy processing system" and "replac[e] the current regulatory framework with one in which market forces determine fees for proxy distribution and other services." Letter from Niels Holch, Exec. Director, Shareholder Comm'cns Coal., to Secretary, Securities and Exchange Commission (Jan. 20, 2021) at 4. The coalition also argued for ongoing oversight of proxy fees by the Commission in the absence of a market-based solution. *Id.* at 5-6.

[38] MFS January 11, 2021 Letter, *supra* note 32, at 1.

designed to permit unfair discrimination between customers, issuers, brokers, or dealers."[39] The Division further reasoned that permitting NYSE to remove the specific rates in its rules would "effectively [] make the maximum reimbursement rates set forth in FINRA rules the industry standard, and establish FINRA as the lead SRO in this area."[40] Accordingly, the Disapproval Order holds that NYSE had the burden of demonstrating that a "FINRA-led regime" would be consistent with Section 6(b) of the Exchange Act.

In the Disapproval Order, the Division relied on NYSE's purported role as "lead SRO in this area."[41] The Division wrote that NYSE "has demonstrated the ability, as a primary listing market that has relationship with both brokers and issuers, to consider the interest of both of these important constituencies when it periodically develops proposals to update the reimbursement rate schedule pursuant to Section 19(b)(2) of the Act."[42] Because FINRA does not have an official regulatory relationship with issuers, the Division reasoned, NYSE had not established that FINRA would be well-positioned to update the existing rate structures in the future.

The Division reached its conclusion even though the Commission long ago approved nearly identical rules for substantially all of NYSE's peer exchanges. On this point, the Division considered the circumstances with respect to NYSE's proposed rule change "unique" given NYSE's consideration of broker and issuer interests, and as the industry standard relied upon by all brokers with street name accounts and issuers. In the Division's view, "[a]pproval of NYSE's proposed elimination of its rate schedule . . . would result in NYSE's relinquishment of an

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[39] Disapproval Order, *supra* note 1, at 47353.

[40] *Id.*

[41] *Id.* at 47354.

[42] *Id.*

important market-wide regulatory function that it currently performs, and without there being evidence in the record of this filing of an available and equally viable alternative for that function."[43]

On August 25, 2021, NYSE submitted a timely notice of intention to petition for review of the Disapproval Order.

LEGAL STANDARDS

Under its Rules of Practice, the Commission will grant a petition for review where the petitioner makes a reasonable showing that "a prejudicial error was committed in the conduct of the proceeding" or that the decision embodies either "a finding or conclusion of material fact that is clearly erroneous," a "conclusion of law that is erroneous, or an "exercise of discretion or decision of law or policy that is important and that the Commission should review."[44] The Commission's review is *de novo*.[45]

Under Section 19 of the Exchange Act, the Commission must approve a rule change if it is consistent with the Exchange Act's requirements and the applicable rules and regulations issued thereunder.[46] The Commission reviews rule changes for consistency with the requirements of Section 6 of the Act.[47] Section 6(b)(5) of the Exchange Act requires that rules of an exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons

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[43] *Id.* at 47355.

[44] 17 C.F.R. §§ 201.431(b)(2), 201.411(b)(2).

[45] *See* Order Setting Aside Action by Delegated Authority and Approving Proposed Rule Change, Release No. 34-88008, at 4 (Jan. 21, 2020), 85 FR 4726, 4727 (Jan. 27, 2020).

[46] 15 U.S.C. § 78s(b)(2)(C)(i).

[47] *See* 17 C.F.R. § 201.431(a) (the Commission may "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, any action made pursuant to [delegated authority]").

engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, or to regulate by virtue of any authority conferred by this chapter matters not related to the purposes of this chapter or the administration of the exchange."[48]

In addition, the Administrative Procedure Act (the "APA") prohibits arbitrary and capricious agency action.[49]

ARGUMENT

The Commission should grant NYSE's Petition because the Disapproval Order is legally erroneous and raises an important issue regarding the disparate treatment of exchanges that warrants Commission review. The Commission should set aside the Disapproval Order because the Disapproval Order arbitrarily and capriciously treats NYSE differently from other exchanges, relies on a rationale that is untethered to the rule change NYSE actually proposed, and arbitrarily imposes an unmeetable evidentiary burden. Moreover, the Commission should approve NYSE's proposed rule change because there is sufficient evidence in the record to demonstrate that the proposed rule change is consistent with the Exchange Act.

I. The Disapproval Order Results in Improper Disparate Treatment of NYSE

The Disapproval Order is arbitrary and capricious and violates Section 19 of the Exchange Act, because the Commission has approved identical rules in the past and the Division has failed to explain why NYSE's proposed change can be held to a different standard. It is

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[48] 15 U.S.C. § 78f(b)(5).

[49] 5 U.S.C. § 706.

well-established law that "[w]here an agency applies different standards to similarly situated entities and fails to support this disparate treatment with a reasoned explanation and substantial evidence in the record, its action is arbitrary and capricious and cannot be upheld."[50]

Here, NYSE's proposal would implement a functionally identical rule to rules already in place at multiple other exchanges and approved by the Commission. Like several other exchanges—and indeed, as expressly provided by Commission Rules 14b-1 and 14b-2—NYSE's proposed rule would limit its member organizations to charging only "reasonable" reimbursement rates for forwarding proxy materials.[51] The proposed NYSE rule also would mandate compliance with any expense reimbursement rate schedule published by any other exchange or SRO of which the subject entities are members. In practice, this would ensure compliance by NYSE members with FINRA's published rate schedule—precisely as Nasdaq's expense reimbursement rule currently requires.[52] When other exchanges sought to adopt these rules, the Commission approved them—without inquiring about the historical role those exchanges played in regulating proxy distribution fees.[53] The Division should have done the same here and approved NYSE's proposed amendment to adopt a functionally equivalent rule.

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[50] *Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd.*, 403 F.3d 771, 777 (D.C. Cir. 2005) (vacating agency's new policy subjecting shippers and carriers to different standards when seeking to vacate a rate prescription for lack of a reasoned basis); *see also McElroy Elec. Corp. v. FCC*, 990 F.2d 1351, 1365 (D.C. Cir. 1993) (emphasizing "the importance of treating similarly situated parties alike or providing an adequate justification for disparate treatment"); *Melody Music, Inc. v. FCC*, 345 F.2d 730, 733 (D.C. Cir. 1965) (FCC must "do more than enumerate factual differences, if any, between appellant and the other cases; it must explain the relevance of those differences").

[51] *See, e.g.*, BZX Exchange R. 13.3; *see also* Investors Exchange R. 6.130 (a Member will be "reimbursed by such issuer for all out-of-pocket expenses, including reasonable clerical expenses").

[52] Nasdaq Stock Market, Gen. R. 9, § 6(b).

[53] In the Matter of the Application of: Investors' Exchange, LLC for Registration as a National Securities Exchange, Release No. 34-78101 (June 17, 2016), 81 FR 41142 (June 23, 2016)

The Division did not purport to treat NYSE in the same way as the other exchanges. Instead, the Division attempted to justify the disparate treatment by claiming that approving the proposal would supposedly "result in NYSE's relinquishment of an important market-wide regulatory function that it currently performs."[54] There are multiple flaws in the Division's reasoning.

First, neither the Division in its Disapproval Order nor any of the commenters identified any benefit that would be achieved by requiring NYSE to maintain in place its existing maximum fee schedule, which was approved in 2013 and which all market participants agree is now outdated.

Second, NYSE is not currently performing any "important market-regulatory function" with regard to expense reimbursement rates that it could "relinquish." The Division apparently hoped that by disapproving NYSE's proposed rule change, it could commandeer NYSE into undertaking a new rate setting effort in place of the Commission. NYSE, however, has no statutory or regulatory obligation to update its expense reimbursement rates on an ongoing basis. The Division's desire to force NYSE into voluntarily shouldering the burden of leading a new, industry-wide effort to update proxy expense reimbursement rates is not a valid consideration for evaluating a proposed rule change under Section 19 or Section 6 of the Exchange Act. To the contrary, the Disapproval Order attempts to unfairly burden NYSE—relative to all other exchanges—by saddling it with the (informal) obligation of undertaking a new regulatory effort at great effort and expense. Placing one exchange at a competitive disadvantage to others

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(approving the IEX rule); Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Modify the Exchange's All-Inclusive Annual Listing Fees for Exchange Traded Products, Release No. 34-87870 (Dec. 30, 2019), 85 FR 391 (Jan. 3, 2020) (approving Nasdaq rule, which adopted FINRA guidance with respect to reasonable rates of reimbursement).

[54] Disapproval Order, *supra* note 1, at 47355.

contravenes the Exchange Act's mandate for the Commission to *promote* competition.[55] Moreover, the unjustified disparate treatment flowing from the Disapproval Order is arbitrary and capricious and must be set aside as a result.[56]

Third, NYSE is not uniquely positioned to regulate in the proxy expense reimbursement space because *some* issuers and *some* broker-dealers are NYSE members. In fact, NYSE is situated exactly the same as every other exchange for purposes of assessing and publishing proxy expense reimbursement rates. Like NYSE, every other listing exchange also has a relationship with some issuers. The only difference is that NYSE previously has published a rate schedule—an outdated rate schedule, if commenters are to be credited—that lingers on its rulebooks unnecessarily.

Fourth, the scope of NYSE's expense reimbursement rate schedule is not even "market-wide," as the Division claimed. NYSE has no relationship with several classes of market participants involved in forwarding proxy materials—mutual funds, banks, the vendors who actually transmit the proxy materials, issuers listed on other exchanges, and non-member broker-dealers. To the extent that any SRO has a market-wide reach in this space, it is FINRA, whose rate schedule applies to every broker-dealer. In fact, NYSE's proposed rule change would have no direct impact on the expense reimbursement rates presently charged because all relevant organizations would be obligated to continue to comply with FINRA's rate schedule. Neither

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[55] *See* 15 U.S.C. § 78c(f) ("[T]he Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation"); *see also id.* § 78w(a)(2) (The Commission "shall not adopt any … rule or regulation which would impose a burden on competition not necessary or appropriate in furtherance of the purposes of [the Act]"); *N.Y. Stock Exch. LLC v. SEC*, 962 F.3d 541, 555 (D.C. Cir. 2020) (vacating Commission rule in part because "the Exchange Act forbids the Commission from adopting a rule that will unnecessarily burden competition, and this statutory command was not met").

[56] *See Adams Telcom, Inc. v. FCC*, 38 F.3d 576 (D.C. Cir. 1994).

the Division nor any commenter has suggested that any real world expense reimbursement rates would change as a direct result of NYSE's proposed rule change.

II. The Disapproval Order Conflates the Proposed Rule Change with Reasoned Rate Setting as a Regulatory Function

The Disapproval Order also makes the fundamental error of conflating NYSE's proposed rule change with the regulatory function of reasoned rate setting. This conflation is independently arbitrary and capricious and reason enough to set aside the Disapproval Order.

While NYSE has historically played a role in expense reimbursement rate-setting, the time when NYSE was uniquely positioned to assume that regulatory burden has long passed for all of the reasons set out above and in NYSE's April 28 response letter.[57]

Since the end of the last century, NYSE's proposed rate schedules have generated calls from market participants urging the participation of the Commission itself or an independent third party to conduct an impartial assessment of expense reimbursement rates. Even the Commission has repeatedly expressed its preference for a market-driven approach to proxy expense reimbursements, rather than rate-setting via SRO rulemaking.[58] And other regulatory initiatives (such as proxy plumbing reform) may eventually change the way that SRO expense reimbursement rates are assessed or set.

But whatever the broader regulatory landscape is or will be, NYSE's proposed rule change could not dictate or upend it. Instead, NYSE's proposal would simply de-publish the nearly decade-old rates that are currently on NYSE's rulebooks—and to zero practical effect on the market given the continued effectiveness of FINRA's equivalent rules. The Division

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[57] *See generally* NYSE Letter, *supra* note 21.

[58] *See* 2013 Approval Order, *supra* note 3, at 63531-32 (citing 2002 Order).

conflated NYSE's discrete proposal with a broader regulatory question and therefore arbitrarily overstated the impact that NYSE's proposal could have on competition and market participants.

The Division's fundamental error in conflating NYSE's discrete rule change proposal with an entire regulatory field pervades the Disapproval Order. Notably, the Division based its disapproval on the Division's perceived lack of "a sufficient basis . . . [to] demonstrate[] how issuers' interests would continue to be adequately considered, and not unfairly discriminated against, in the expense reimbursement rate-setting process if the Exchange were to relinquish its lead role in this area."[59] But NYSE's rules do not require it to play the "lead role in this area," and thus any impacts of NYSE's relinquishing such a role are outside the scope of the rule change proposal and cannot support the Disapproval Order.

Moreover, the evidentiary showing demanded by the Division is arbitrarily vague, because the Division failed to specify how NYSE could conceivably build a record that issuers' views will be taken into account under a regulatory regime that is not fully formed. Agency action "must not be 'vague and indecisive,'" and must afford petitioners with a "principled way" to meet the agency's requirements.[60] The Division offered no specifics about how NYSE could go about demonstrating the capabilities of FINRA (or some other exchange or SRO)—over which NYSE exercises no control—to adequately consider issuers' interests in proxy expense reimbursement rates. It is impossible for NYSE to determine based on the Disapproval Order what evidentiary showing the Division has in mind, much less whether any submission NYSE conceivably might make could ever satisfy the Division's nebulous standard. The impossible overbreadth of the Division's standard for "sufficient information" stands in stark relief against

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[59] Disapproval Order, *supra* note 1, at 47353.

[60] *See Rapoport v. SEC*, 682 F.3d 98, 107 (D.C. Cir. 2012) (quoting *SEC v. Chenery Corp.*, 332 U.S. 194, 196-97 (1947)).

the modest rule change proposed by NYSE, which would only de-publish an existing out-of-date rate schedule, and which would concededly have no direct impact on rates for proxy expense reimbursement.

CONCLUSION

For the foregoing reasons, the Commission should grant NYSE's petition, set aside the Division's Disapproval Order and allow the proposed rule change to take effect. The Division's analysis failed to fulfill its responsibilities under the Exchange Act and the APA, and the proposed rule change satisfies the statutory criteria for approval.

Dated: September 1, 2021
New York, New York

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By: _____

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CERTIFICATE OF SERVICE

I, Paul S. Mishkin, counsel to the New York Stock Exchange LLC ("NYSE"), hereby certify that on September 1, 2021, I caused to be served copies of the attached Petition for Review of Order Disapproving a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-92700, File No. SR-NYSE-2020-96 on the U.S. Securities and Exchange Commission at the following address:

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090
Email: Secretarys-Office@sec.gov
(*via email and FedEx*)

Dated: September 1, 2021
New York, New York

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