



INVESTMENT COMPANY INSTITUTE

CRAIG S. TYLE
GENERAL COUNSEL

September 15, 2003

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors (File No. S7-14-03)

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to express its views on the Securities and Exchange Commission's recent proposal to enhance disclosure regarding the operation of nominating committees and to require new disclosure regarding the means, if any, by which shareholders may communicate with directors.² The proposal applies to the proxy statements of all companies, including investment companies.³ Investment companies are both shareholders of the companies in which they invest and issuers with their own directors and shareholders. Accordingly, the Institute is interested in ensuring that any disclosure required regarding the nomination of directors and the ability of shareholders to communicate with directors of the companies in which they have invested is necessary and appropriate.

The Institute generally supports the Commission's proposal. The Institute does not believe that there is any reason for the Commission to distinguish investment companies from other issuers in the general application of the proposed disclosure requirements. Shareholders of investment companies, like those of operating companies, may benefit from enhanced transparency of board operations. In addition, disclosure regarding the means by which shareholders would communicate with directors may facilitate the ability of investment company shareholders, like other shareholders, to voice any concerns.

Notwithstanding our general support, we have several certain specific comments on the proposal, each of which is set forth below.

¹ The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,655 open-end investment companies ("mutual funds"), 588 closed-end investment companies, 106 exchange-traded funds and 6 sponsors of unit investment trusts. Its mutual fund members have assets of about \$6.857 trillion, accounting for approximately 95% of total industry assets, and 90.2 million individual shareholders.

² SEC Release Nos. 34-48301; IC-26145 (August 8, 2003) [68 FR 48724 (August 14, 2003)] ("Release").

³ See proposed paragraphs (e) of Item 7 and (b) of Item 22 of Schedule 14A under the Securities Exchange Act of 1934.

I. Enhanced Disclosure Regarding the Nominating Committee and Nominating Process

Investment companies currently are required to disclose whether they have a nominating committee and, if so, whether the committee considers nominees recommended by shareholders and how any such recommendation may be submitted.⁴ The Commission has proposed several new disclosure requirements that would significantly expand disclosure in proxy statements regarding the nominating committee and the nominating process. Our comments regarding this portion of the proposal are set forth below.

A. Interested Persons

Under the proposal, an investment company would be required to disclose whether or not the members of its nominating committee are "interested persons" of the investment company as defined in Section 2(a)(19) of the Investment Company Act of 1940, rather than "independent" as defined under the listing standards of a national securities exchange or national securities association, as in the case of operating companies. The Commission requests comment on whether the Investment Company Act's definition of "interested person" should be applied in requiring disclosure regarding the independence of members of an investment company's nominating committee.

We believe that the independence of a director of an investment company should be determined exclusively under Section 2(a)(19) of the Investment Company Act because that test is tailored to the types of conflicts of interest faced by investment company directors.⁵ Accordingly, we strongly support this aspect of the proposal.

B. Identifying Sources of Nominees Included in Proxy Statements

Under the proposal, issuers, including investment companies, would be required to provide a statement of the specific source, such as the name of an executive officer or other individual, of each nominee approved by the nominating committee for inclusion in their proxy statements. The Release requests comment on this proposed requirement, including whether the Commission should permit the source to be identified by category rather than by name.

The Institute notes that the Release does not provide a specific rationale for requiring disclosure of the name of the source of a nominee, and we do not believe that such disclosure would be meaningful. Instead, we recommend that the Commission permit the sources to be identified by category. Categorical identification (*e.g.*, management or independent directors) should be more relevant information for a shareholder than an individual's name.

⁴ See Item 22(b)(14)(iv) of Schedule 14A.

⁵ Consistent with our views on this aspect of the Commission's proposal, we have previously urged Nasdaq to modify its corporate governance proposal to clarify that the independence of a director of an investment company should be determined exclusively under Section 2(a)(19) of the Investment Company Act. See Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Craig S. Tyle, General Counsel, Investment Company Institute, dated April 15, 2003.

C. Disclosure of Changes in Procedures

Under the proposal, if a company's nominating committee considers candidates recommended by shareholders, disclosure of the procedures to be followed by shareholders in submitting such recommendations would be required.⁶ The Release requests comment on whether the Commission should require disclosure in the next Form 10-Q, Form 10-QSB, or Form 8-K of any changes made during the year to any procedure for shareholders to recommend director nominees.⁷ Unlike operating companies, investment companies generally are not required to file quarterly reports or reports on Form 8-K.⁸ Accordingly, if the Commission adopts such a requirement, we request that it clarify that investment companies may disclose any changes in their procedures on Form N-CSR, which is filed semi-annually.⁹

II. *Disclosure Regarding the Ability of Shareholders to Communicate with Directors*

The Commission has proposed requiring each issuer to disclose in its proxy statement for the election of directors whether or not its board provides a process for shareholders to send communications to the board and, if it does not have such a process, a statement of the specific basis for the board's view that it is appropriate for the issuer not to have such a process. Our specific comments on this portion of the proposal are set forth below.

A. Description of Board Action Resulting from Shareholder Communications

Under the proposal, any company that has a process for its shareholders to communicate with the board would be required to describe in its proxy statement any material action taken by the board during the preceding fiscal year as a result of communications from shareholders. The Institute is concerned that requiring this disclosure may discourage companies from taking certain actions if they have to disclose that they did so in response to a shareholder communication. The Release requests comment on whether any categories of communications should be excluded from coverage of the rule including, for example, whether the rule should apply only to formal petitions to the entire board.¹⁰ We believe that limiting the

⁶ Proposed Item 7(d)(2)(ii)(G) of Schedule 14A.

⁷ See Release at p. 48728.

⁸ See Rule 30d-1 under the Investment Company Act (generally exempting registered investment companies from the requirement to file quarterly reports) and Rules 13a-11 and 15d-11(b) under the Exchange Act (generally exempting registered investment companies from Form 8-K filing requirements). Regulation Blackout Trading Restriction represents the only instance where the Commission has required investment companies to report on Form 8-K. In one other instance, Regulation Fair Disclosure, the Commission permitted investment companies to use Form 8-K as one of several alternative permissible methods for reporting.

⁹ In addition, we recommend that the Commission refine any such updating requirement to mandate disclosure of any "material" changes to the procedures for submitting recommendations for director nominees. The recommended approach should satisfy the Commission's goal of assuring that shareholders are provided with the information necessary for submitting recommendations while eliminating the unnecessary burden of disclosing immaterial changes to procedures (*i.e.*, changes that would not result in disqualifying from consideration the shareholder's recommended nominee because of the shareholder's failure to comply with the procedures, as amended).

¹⁰ See Release at p. 48730.

rule in this manner would address the concerns noted above. Accordingly, we recommend that the Commission revise this aspect of the rule so that it will only apply to action taken as a result of formal petitions from shareholders to the board.

B. Commission's Role Regarding Procedures for Shareholder Communications with Directors

The proposed rules relating to shareholder communications with directors are disclosure standards only and do not require issuers to adopt any specific procedures regarding these communications. The Release requests comment, however, on whether the Commission should provide guidance on what it views as appropriate procedures for issuers to implement with regard to shareholder communications with directors. We believe that investment companies and their boards are in the best position to determine the most appropriate procedures for their own organizations. They are able to design their own procedures taking into account, for example, their own business model and any other existing procedures. Accordingly, we do not believe that it is necessary or appropriate for the Commission to set forth guidance regarding what it views as appropriate procedures for shareholder communications with investment company boards for the diverse universe of investment companies.

C. Process for Determining Which Communications Will Be Sent to Directors

Under the proposal, if all shareholder communications are not sent directly to board members, a registrant would be required to describe its process for determining which communications will be relayed to board members, including identification of the department or other group "within the registrant" that is responsible for making this determination.¹¹ Almost all investment companies are externally managed, with investment management, administrative, and other services provided by third parties and, thus, do not have their own employees. Accordingly, we recommend that the Commission modify the proposed requirement with respect to investment companies to reflect that their processes for handling communications between shareholders and directors may permit personnel from investment company service providers to determine which communications should be relayed to investment company board members.

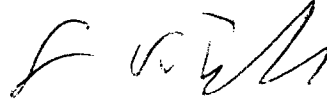
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¹¹ See proposed Item 7(h)(2)(iii) of Schedule 14A.

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We appreciate the Commission's consideration of our comments. If you have any questions or need additional information, please contact me at (202) 326-5815 or Dorothy Donohue at (202) 218-3563.

Sincerely,

A handwritten signature in black ink, appearing to read "Craig S. Tyle". The signature is fluid and cursive, with the first name "Craig" being the most prominent.

Craig S. Tyle
General Counsel

cc: Alan L. Beller, Director
Martin P. Dunn, Deputy Director
Division of Corporation Finance

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U.S. Securities and Exchange Commission