

March 27, 2009

Ms. Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NW  
Washington, D. C. 20549-1090

Re: Notice of Filing of Proposed Rule Change to Amend NYSE Rule 452 to Eliminate Broker Discretionary Voting for the Election of Directors and Codify Interpretations that Do Not Permit Broker Discretionary Votes for Material Amendments to Investment Advisory Contracts (File No. SR-NYSE-2006-92)

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> is writing to provide its views on proposed changes to New York Stock Exchange Rule 452 that would eliminate discretionary broker voting for the election of directors.<sup>2</sup> The proposal is the end product of a lengthy undertaking to examine the proxy voting process. Much of this work was accomplished under the auspices of the NYSE's Proxy Working Group ("Working Group"), a group created by the NYSE in April 2005 to review its rules regulating proxy voting.<sup>3</sup> We commend the Working Group for its thoughtful consideration of comments provided by the investment company industry throughout its examination and welcome the opportunity to provide our comments on the proposal, now that the Securities and Exchange Commission has formally published the proposal for public comment.

## **I. Background**

The Institute held discussions on the proposal with, and provided input to, the Working Group, the NYSE, and the Commission on several occasions throughout the proposal's

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of \$9.88 trillion and serve over 93 million shareholders.

<sup>2</sup> See Securities Exchange Act Release No. 59464 (February 26, 2009), 74 FR 9864 (March 6, 2009).

<sup>3</sup> See *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006).

development.<sup>4</sup> Most significantly, to assist the Working Group and NYSE staff in considering the impact of the proposal on investment companies, the Institute surveyed its members and prepared a report<sup>5</sup> based on the data gathered from the survey.<sup>6</sup>

As discussed in more detail below, the ICI Report concluded that the proposal would have a disproportionate impact on investment companies and would create significant difficulties for investment companies in achieving quorums and electing investment company directors.<sup>7</sup> Accordingly, the Institute urged the Working Group and the NYSE to except investment companies from the proposal.

The Institute supports the proposal, as amended. We are pleased that the Working Group and the NYSE amended the original proposal to preserve discretionary broker voting for investment companies and that they attached particular significance to the findings of the ICI Report.

We recommend, however, that the NYSE make a technical change to the proposed language of amended Rule 452 to clarify that the proposal also excepts business development companies (“BDCs”) that elect to be regulated under the Investment Company Act. As discussed below, we also support the

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<sup>4</sup> See Letter from Frances M. Stadler, Deputy Senior Counsel, Investment Company Institute, to Mr. Larry Sonsini, Chairman, NYSE Proxy Working Group, Wilson, Sonsini, Goodrich & Rosati, dated June 3, 2005; Letter from Elizabeth R. Krentzman, General Counsel, Investment Company Institute, to Catherine R. Kinney, President and Chief Operating Officer, NYSE Group, dated July 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to Richard Ketchum, Chief Executive Officer, NYSE Regulation, dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to Catherine R. Kinney, President and Co-Chief Operating Officer, NYSE Group, Inc., dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated February 20, 2007; and Statement of Paul Schott Stevens, President and CEO, Investment Company Institute before the SEC Proxy Roundtable, dated May 24, 2007.

<sup>5</sup> See *Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors* (December 18, 2006) (“ICI Report”). A copy of the ICI Report is attached as Appendix A.

<sup>6</sup> The ICI Report also was based on data provided by Automatic Data Processing, Inc. (now known as Broadridge Financial Solutions, Inc.) which reviewed a large number of shareholder meetings and provided the Institute with additional information necessary to assess the effect of the proposal on the ability of investment companies to obtain the required quorum and votes needed to elect directors.

<sup>7</sup> Other groups shared the Institute’s view on the impact of the proposal on investment companies. For example, the Committee on Capital Markets Regulation, an independent, bipartisan committee composed of corporate and financial leaders established to set forth recommendations on ways to improve the efficiency and competitiveness of the U.S. capital markets, acknowledged the difficulties that the proposal would cause for investment companies. While the Committee supported the application of the NYSE proposal to corporate issuers in its interim report, the Committee stated that it believes that the application of the proposal to voting by investment company shareholders “should be reconsidered in light of the practicalities of such situations.” See Interim Report of the Committee on Capital Markets Regulation, November 30, 2006 (as revised December 5, 2006) at p. 128.

codification in Rule 452 of certain NYSE interpretations regarding investment advisory contracts. Our specific comments on the proposal follow.

## **II. Impact of Eliminating Discretionary Broker Voting on the Election of Investment Company Directors**

The Institute has a long-standing policy of supporting strong corporate governance and agrees that shareholder voting for directors can be an important component of a robust corporate governance structure. As applied to investment companies, however, the proposal would have no demonstrable benefits, and certainly none that come close to offsetting its costs.

As discussed in the ICI Report, the proposal would have adverse effects on investment companies for several reasons. First, the proposal would create significant difficulties for investment companies in achieving quorums, and, in turn, would occasion unnecessary delays in electing investment company directors. In addition, to encourage shareholders to vote their proxies, investment companies would be forced to adjourn meetings and/or engage in multiple solicitations, thereby significantly increasing costs to investment companies. The proposal also would have a disproportionate impact on investment companies as opposed to operating companies. Because investment companies have a far higher proportion of retail shareholders than most operating companies and retail shareholders are less likely than institutional investors to vote their proxies, investment companies would incur disproportionately greater costs from the elimination of discretionary broker voting. Finally, because the elections that are the subject of the NYSE proposal are uncontested, the same directors, in virtually every case, would be elected whether or not investment companies and their shareholders bear these steep additional costs. Therefore, we believe that the current process does not entail any detrimental effects on investment companies or investment company governance.

### **A. Eliminating Discretionary Broker Voting Would Have a Disproportionate Impact on Investment Companies**

Investment companies have a far higher proportion of retail shareholders than most operating companies. Because retail shareholders are less likely than institutional investors to vote their proxies (many institutional investors have a fiduciary responsibility to do so), eliminating discretionary broker voting for investment companies would have a disproportionate impact on investment companies, and investment companies would incur greater costs from the elimination of discretionary broker voting. The ICI Report found that while retail shareholders hold about forty-eight percent of the value of operating company shares, they hold about sixty-four percent of the value of mutual fund shares. This disparity is even greater for closed-end funds, where retail investors own about ninety-eight percent of the value of shares.

The ICI Report reflected data as of year-end 2005, but the data remains consistent. Retail shareholders held about forty-five percent of the value of operating company shares as of December

2008, sixty-four percent of the value of mutual fund shares as of December 2007, and approximately ninety-five percent of closed-end fund shares as of December 2008.<sup>8</sup> We have no reason, therefore, to believe that the findings of the ICI Report would be any different today.

### **B. Eliminating Discretionary Broker Voting Would Cause Significant Difficulties in Investment Companies Achieving a Quorum**

NYSE members hold a substantial portion of investment company shares in street name.<sup>9</sup> The ICI Report found that half of investment companies sold through sales forces had at least 80 percent of the investment company's total shares outstanding held in this manner. The ICI Report also found that beneficial shareholders tend to return their proxies at a fairly low rate – only approximately thirty two percent of investment company shares held in street name were voted by beneficial owners. In contrast, when brokers are permitted to vote uninstructed shares, almost all shares (ninety-three percent) held in street name were voted. A majority of outstanding shares often must be voted for an investment company to achieve a quorum with respect to matters pertaining to the election of directors. If broker voting of investment company shares held in street name was eliminated, significant difficulties for investment companies would be created in achieving a quorum, and, in turn, electing investment company directors. An uncontested director election by its nature is highly unlikely to elicit strong interest or participation from rank and file investment company shareholders, only fifteen percent of whom ascribe significance to information about a mutual fund's directors when selecting a mutual fund, according to an Institute survey.<sup>10</sup>

### **C. Eliminating Discretionary Broker Voting Would Cause Investment Company Proxy Costs to More than Double**

Because a significant number of investment company shareholders choose not to vote shares held in street name, investment companies are forced to incur increased costs from taking steps necessary to encourage shareholders to vote their proxies.<sup>11</sup> The ICI Report showed that these costs are

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<sup>8</sup> We have provided the most recent data available for each type of company. With respect to operating companies, we based our calculation on data from the World Federation of Exchanges and the Federal Reserve Board; with respect to mutual funds, we used data from the ICI Institutional Survey and the Federal Reserve Board; with respect to closed-end funds, we used data from two large closed-end fund complexes with close to thirty percent of total closed-end fund assets under management. We used these same data sources for the ICI Report.

<sup>9</sup> The proposal applies to proxies relating to investment companies whose shares are held through NYSE member firms.

<sup>10</sup> See *Understanding Investor Preferences for Information*, Investment Company Institute (2006).

<sup>11</sup> To obtain approval of matters on which brokers are not permitted to vote ("non-routine matters"), it is frequently necessary for investment companies to engage soliciting firms and conduct multiple mailings, the cost of which can be significant. Even with these measures, investment companies often must adjourn meetings due to an insufficient voting response. The ICI Report indicated that no shareholder meeting in our entire sample with only routine matters on the agenda required a re-solicitation of shareholders or was adjourned for lack of a quorum. This result was due to the high rate

significant. Because investment companies would have to engage in multiple solicitations, typical proxy solicitation costs would more than double from \$1.65 to \$3.68 for each shareholder account.

Investment company expense ratios would rise between one to two basis points, on average, with some investment companies' expense ratios increasing more than five basis points.<sup>12</sup> Because the elections that are the subject of the NYSE proposal are uncontested, the same directors will be elected whether or not investment companies bear these increased costs.

### **III. Business Development Companies Should be Excepted from the Proposal**

The amended NYSE proposal would except "registered investment companies" from the elimination of discretionary broker voting. By drafting the exception to include only "registered" investment companies, the exception would not include a segment of the investment company industry known as business development companies, or BDCs.

BDCs share many of the same characteristics of registered investment companies and, most significantly, the two characteristics of investment companies that the Working Group attached particular significance to in creating the exception – the regulatory structure for investment companies under the Investment Company Act and the large retail shareholder base of investment companies. In addition, from what we can tell, it appears that the omission of BDCs from the exception was unintentional, as the discussion in the ICI Report and prior comment letters, as well as in the NYSE's amended proposals (and its discussion of the Working Group's views in those proposals) refer only to "investment companies" and not to "registered investment companies."<sup>13</sup>

It would therefore be consistent with the Working Group's reasoning to treat BDCs for purposes of the proposal in the same manner as registered investment companies.<sup>14</sup>

#### **A. BDC Regulatory Structure is Akin to Registered Investment Companies**

BDCs are "investment companies," as defined in the Investment Company Act, because they are primarily engaged in investing, reinvesting, or trading in securities.<sup>15</sup> They are considered a type of

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at which brokers vote. In contrast, more than half of shareholder meetings in our sample with at least one non-routine matter required at least one re-solicitation.

<sup>12</sup> These expected increases in expense ratios from eliminating broker voting are about on par with the cost of custody fees, a basic service provided to all investment companies, as required by the Investment Company Act, to protect assets.

<sup>13</sup> For example, the Working Group stated it "reviewed and considered the fact that that investment companies are subject to regulation under the Investment Company Act of 1940" and that it "unanimously recommend[s] that such changes to Rule 452 not apply to any company subject to the Investment Company Act of 1940." See *Addendum to Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (August 27, 2007) at p. 3.

<sup>14</sup> Appendix B contains recommended draft language that could be used to effectuate this change.

<sup>15</sup> See Section 3(a)(3) of the Investment Company Act (defining investment company).

closed-end investment company, formed primarily to assist small businesses by furnishing them with capital through purchasing their securities and offering them significant managerial assistance.<sup>16</sup> The Investment Company Act prescribes a regulatory regime for BDCs to facilitate the formation of capital for small businesses.<sup>17</sup> Under that regulatory scheme, BDCs are not required to register under the Investment Company Act and, thus, technically are not “registered investment companies.” They do, however, elect to be regulated under the Investment Company Act and are subject to many of the same corporate governance requirements as registered investment companies.

For example, a majority of a business development company’s directors must be independent;<sup>18</sup> certain persons are prohibited from serving as employees, officers, directors, or investment advisers of a BDC;<sup>19</sup> a BDC’s contract with its investment adviser (and any material amendments thereto) must be approved by a majority of its outstanding voting securities; the advisory contract may only continue for more than two years if the board or a majority of outstanding voting securities approves its continuance annually; a majority of independent directors must approve advisory contracts and renewals thereof;<sup>20</sup> independent directors must select a BDC’s independent auditor;<sup>21</sup> and a BDC may not change the nature of its business so as to cease to be a BDC without the approval of a majority of its outstanding voting securities.<sup>22</sup>

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<sup>16</sup> See Section 2(a)(48) of the Investment Company Act (defining business development company as a domestic closed-end investment company, operated for the purpose of making certain types of investments, which makes available significant managerial assistance to the companies in which it invests).

<sup>17</sup> See Section 55(a)(2) of the Investment Company Act (requiring seventy percent of a business development company’s assets to be invested in, among other things, securities purchased in a nonpublic offering from an eligible portfolio company).

<sup>18</sup> See Section 56 of the Investment Company Act. This particular provision imposes a more stringent requirement on BDCs as compared to registered investment companies. While a majority of a BDC’s directors must not be “interested persons” (a defined term in Section 2(a)(19) of the Investment Company Act), forty percent of registered investment company’s directors must not be interested persons. In practice, both registered investment companies and BDCs greatly exceed the statutory requirements by typically having 75% of their boards comprised of independent directors.

<sup>19</sup> See Section 59 of the Investment Company Act. The persons subject to this prohibition include persons convicted within the last ten years of certain felonies or misdemeanors involving specified securities-related activities, and persons temporarily or permanently enjoined from engaging in certain securities-related activities.

<sup>20</sup> See Section 59 (applying Sections 15(a) and (c) of the Investment Company Act to BDCs to the same extent that the provisions apply to registered closed-end investment companies).

<sup>21</sup> See Section 59 (applying Section 32(a) of the Investment Company Act to BDCs to the same extent that the provision applies to registered closed-end investment companies).

<sup>22</sup> See Section 58 of the Investment Company Act. There are some additional Investment Company Act requirements that apply to shareholders of registered investment companies and not to BDC shareholders. Section 13 of the Investment Company Act requires shareholder approval for a registered investment company to change from an open-end, closed-end, diversified, or non-diversified company; to borrow money, issue senior securities, underwrite securities issued by other

## **B. BDCs Have a Large Retail Shareholder Base**

Like registered investment companies, BDCs have a far higher proportion of retail shareholders than most operating companies. An estimated sixty-three percent of BDC shares, on average, are held by retail investors.<sup>23</sup> Because these shareholders tend to vote at a fairly low rate, BDCs would be subject to the same increased costs and burdens that would be experienced by registered investment companies if discretionary broker voting is eliminated for the election of directors.<sup>24</sup>

## **IV. Voting on Investment Advisory Contracts**

The proposal would preclude discretionary broker voting on: (i) a material amendment to an investment company's investment advisory contract; and (ii) an investment company's investment advisory contract with a new investment adviser, which approval is required by the Investment Company Act and the rules thereunder.<sup>25</sup> The Release notes that the proposed change would codify longstanding NYSE interpretations on these issues. We support the codification of these interpretations in Rule 452.

We agree that these matters are the types of non-routine matters on which investment company shareholders should be required to vote. As a legal matter, investment companies generally are organized as corporations or business trusts with a board of directors or trustees. Practically speaking, however, investment companies are a means through which investors obtain the services of the investment company's investment adviser. When investors become shareholders of an investment company, they already have chosen the adviser in the context of the disclosures in the investment company's prospectus and other documents that set forth the material facts concerning the adviser, the investment company's investment objectives, strategy and risks, the management fee structure, and

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persons, purchase or sell real estate or commodities or make loans to other persons, except in accordance with the policy in its registration statement; or to deviate from a stated policy with respect to concentration of investments in an industry or industries, from any investment policy which is changeable only by shareholder vote, from any stated fundamental policy, or to change the nature of its business so as to cease to be an investment company. As explained in the legislative history accompanying the legislation that created BDCs, these provisions do not apply to BDCs because the Investment Company Act prescribes the limits of the fundamental investment policy of a BDC and because BDCs represented that, in order to effectively provide financing to new small and medium-sized companies, their investment policies must be flexible. *See* S. Rep. No. 958, 96<sup>th</sup> Cong., 2d Sess. at 33 (1980) and H.R. Rep. No. 1341, 96<sup>th</sup> Cong., 2d Sess. at 51-52.

<sup>23</sup> This percentage is based on individual ownership data gathered from <http://finance.yahoo.com>.

<sup>24</sup> One Institute BDC member recently reported spending \$1.4 million to solicit shareholders on a non-routine matter. The meeting was adjourned twice for failure to achieve a quorum, costing approximately \$7.70 per shareholder account.

<sup>25</sup> For example, broker discretionary voting is not permitted with respect to an advisory contract between an investment company and a new investment adviser due to an assignment of the investment company's investment advisory contract, including an assignment caused by a change in control of the investment adviser that is a party to the assigned contract.

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other expenses of investing in the investment company.<sup>26</sup> Given the importance of the identity of the adviser and the services it provides to investment company shareholders, we believe the benefits of shareholders' voting on a material amendment to an advisory contract or an advisory contract with a new investment adviser outweigh the costs associated with such a requirement.

\* \* \* \* \*

We offer our continued assistance as the Working Group and the NYSE continue to examine these and other issues surrounding broker voting. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5815, Ari Burstein at (202) 371-5408, or Dorothy M. Donohue at (202) 218-3563.

Sincerely,

/s/ Karrie McMillan

Karrie McMillan  
General Counsel

cc: The Honorable Mary L. Schapiro  
The Honorable Kathleen L. Casey  
The Honorable Elisse B. Walter  
The Honorable Luis A. Aguilar  
The Honorable Troy A. Paredes  
Andrew J. Donohue, Director, Division of Investment Management  
Erik R. Sirri, Director, Division of Market Regulation  
U.S. Securities and Exchange Commission

Scott Cutler, Executive Vice President  
Judith C. McLevey, Managing Director  
John Carey, Chief Counsel – U.S. Equities  
NYSE Euronext

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<sup>26</sup> See e.g., Jaretzki, Jr. Alfred, "Duties and Responsibilities of Directors of Mutual Funds," 29 Law and Contemporary Problems 777, 786 (1964) (stating that as a draftsman of the Investment Company Act pointed out, "[T]he board of directors does not act in a vacuum ... [The] stockholders either have chosen the existing management or they have bought their shares in probable reliance on such management. Presumably, they have confidence in the management and would not expect the directors to take action to change it except in unusual circumstances.").



**Appendix A**

**Institute Report on Costs of Eliminating Discretionary Broker Voting on Uncontested Elections  
of Investment Company Directors**

# Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors

December 18, 2006



# Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors

December 18, 2006



1401 H. Street, NW Suite 1200  
Washington, DC 20005-2148  
202/326-5800

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## Executive Summary

### BACKGROUND

Under New York Stock Exchange (“NYSE”) Rule 452, NYSE members—which consist primarily of brokers and banks—are allowed to vote uninstructed proxies for their customers who beneficially own the stock on routine items at shareholder meetings. This practice is commonly referred to as discretionary broker voting. Currently, an uncontested election of directors is considered a routine item, and NYSE members are allowed to vote proxies for beneficial owners who have not returned their proxies within 10 days of the date of the shareholder meeting.

In June 2006, the NYSE’s Proxy Working Group recommended the elimination of discretionary broker voting by NYSE members in an uncontested election of directors.<sup>1</sup> The NYSE subsequently filed a rule proposal with the Securities and Exchange Commission (“SEC”), which, if approved by the SEC, would effectuate this change to discretionary broker voting for uncontested elections of directors. If approved, the rule proposal would apply to proxies relating to closed-end funds and mutual funds whose shares are held through NYSE member firms.

Investment companies generally hold shareholder meetings when required by state law or the Investment Company Act of 1940 and as otherwise needed to conduct corporate business. In addition, closed-end funds listed on the NYSE and other exchanges are required to hold annual shareholder meetings at which the election of directors is a matter presented for shareholder vote. Often, the election of directors is the only matter put before closed-end shareholders at annual meetings.

### SURVEY DESIGN

The Investment Company Institute (“Institute”) surveyed members regarding their experiences with shareholder voting to assess the impact of the NYSE’s rule proposal.<sup>2</sup> We received information with respect to 105 shareholder meetings of both closed-end funds and mutual funds from 40 different fund complexes. Many funds were able to provide complete information on types of matters presented for shareholder vote, quorum requirements, number of re-solicitations and adjournments, and total proxy solicitation costs for their most recent shareholder meetings.

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Rochelle Antoniewicz, ICI Senior Economist, prepared this report.

<sup>1</sup> See *Report and Recommendation of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006).

<sup>2</sup> A copy of the survey is provided in the Appendix.

Automatic Data Processing, Inc. (“ADP”) reviewed 881 fund shareholder special and annual meetings held in 2005 and, based on this review, provided information on the portion of fund shares held in street name, the portion of fund shares voted by brokers, and the portion of fund shares held by objecting beneficial owners—critical pieces of information necessary to assess the effect of discretionary broker voting on the ability of funds to obtain the required quorum and vote needed to elect directors.<sup>3</sup>

## KEY FINDINGS

Our key findings on the effect of eliminating discretionary broker voting for uncontested elections of directors of investment companies are summarized below.

- Eliminating discretionary broker voting will have a disproportionate impact on funds as compared to operating companies because funds have a higher proportion of retail investors.
- NYSE members hold a substantial portion of fund shares in street name. Half of closed-end funds and mutual funds sold through sales forces had over 80 percent of the fund’s total shares outstanding held in street name.
- If discretionary broker voting is eliminated, typical proxy costs are estimated to more than double from \$1.65 per shareholder account to \$3.68 per shareholder account because many funds will have to engage in multiple solicitations. Even with re-solicitations, more shareholder meetings will be adjourned.
- Beneficial owners tend to return their proxies at a fairly low rate, and discretionary broker voting is an important mechanism for achieving quorum in uncontested elections of directors. Typically, only about one-third of mutual fund shares held in street name are voted by beneficial owners.
- Conservative analysis indicates that fund expense ratios could rise by approximately 1 to 2 basis points owing to higher proxy costs. For funds with smaller average account balances and more than the normal difficulties in obtaining voted proxies, expense ratios could increase by as much as 5 basis points.
- Small fund advisers are likely to bear a significant burden from the elimination of discretionary broker voting because many will have to assume higher proxy costs given the competitive nature of the mutual fund industry. Additional costs on small fund advisers create disincentives for entrepreneurs to enter the industry and push fund advisers with thin profit margins out of the business.

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<sup>3</sup> Respondents to the Institute’s survey were largely unable to provide this information.

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## **Factors Affecting Total Proxy Costs From Eliminating Discretionary Broker Voting**

In our assessment of the difficulties associated with eliminating discretionary broker voting, we examined several factors that will affect total proxy costs:

- Retail ownership of fund shares;
- NYSE members' holdings of fund shares;
- Voting response by beneficial owners of fund shares held in street name;
- Shares held by beneficial owners that cannot be contacted directly by funds; and
- Frequency of re-solicitations and adjournments of shareholder meetings with non-routine matters.

### **LARGE RETAIL OWNERSHIP CREATES A DISPROPORTIONATE IMPACT ON FUNDS**

The portion of shares held by retail investors will significantly affect the cost of soliciting votes in an uncontested election of directors, as institutional investors are more likely to vote their shares than are retail shareholders.<sup>4</sup> Investment advisers to closed-end funds and mutual funds, for example, have a duty of care requirement to monitor corporate actions and vote client proxies in many instances. Fiduciaries to private pension plans—typically plan sponsors—are subject to similar requirements under ERISA.

Many large and mid-sized publicly traded operating companies have a majority of their shares held by institutional investors and will be less affected by the elimination of discretionary broker voting. Based on analysis ADP provided to the NYSE's Proxy Working Group, for NYSE-listed operating companies with more than five thousand shareholders, beneficial owners voted, on average, roughly 60 percent of the companies' total shares outstanding. Many of these voted shares are likely from institutional holders. Private pension plans and registered investment companies hold almost 40 percent of publicly traded operating companies' market value. As shown in Figure 1, retail shareholders are estimated to hold a little less than half of the aggregate value of operating companies' publicly traded stock.

Many funds have a majority of their shares held by retail shareholders and will have significant difficulties in achieving a quorum and obtaining the required votes to elect directors. In the aggregate, retail shareholders are estimated to hold about two-thirds of mutual fund assets and nearly all closed-end fund assets (Figure 1). Moreover, private pension plans hold only about 20 percent of mutual fund assets, including money market assets. While these aggregate figures are useful, they tend to mask any dispersion that may be present. In examining

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<sup>4</sup> Institutional investors include private and government pension plans, investment advisers, insurance companies, depositories, municipalities, and proprietary accounts of brokers and dealers.

the distribution of retail holdings of mutual funds more closely, we found that for half of mutual funds, retail shareholders hold at least 82 percent of the fund's assets. The high percentage of retail shareholders helps to explain why, on average, only about one-third of beneficial owners with shares held in brokerage and bank nominee accounts voted their shares on routine matters.

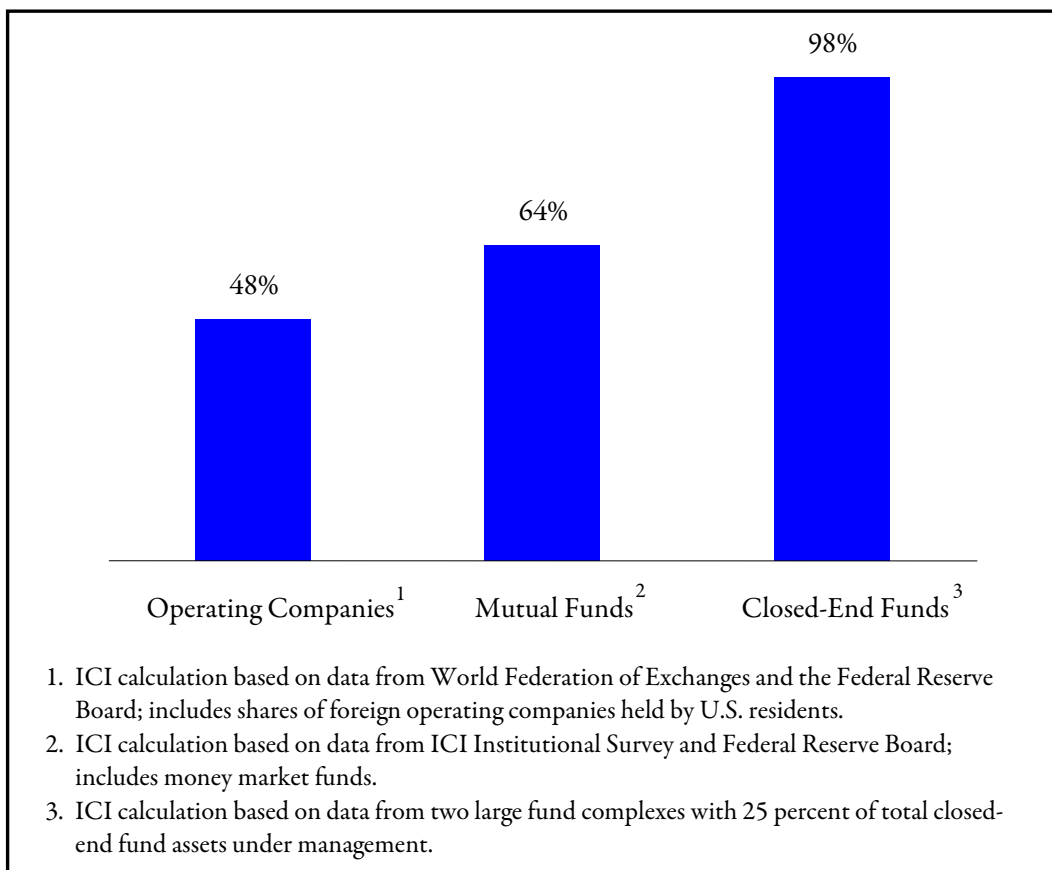
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**Figure 1**

**Estimated Retail Holdings of Operating Companies and Funds**

Percent of Aggregate Market Value of Shares

Year-End 2005



**NYSE MEMBERS' HOLDINGS OF FUND SHARES ARE SUBSTANTIAL**

Another factor that will affect the cost of eliminating discretionary broker voting is the portion of fund shares held by NYSE members. The vast majority of investment company shareholders buy fund shares through intermediaries, including intermediaries that are NYSE member firms. Consequently, for many funds (particularly those that distribute to retail investors through financial advisers at national wirehouses, regional broker-dealers and banks) a

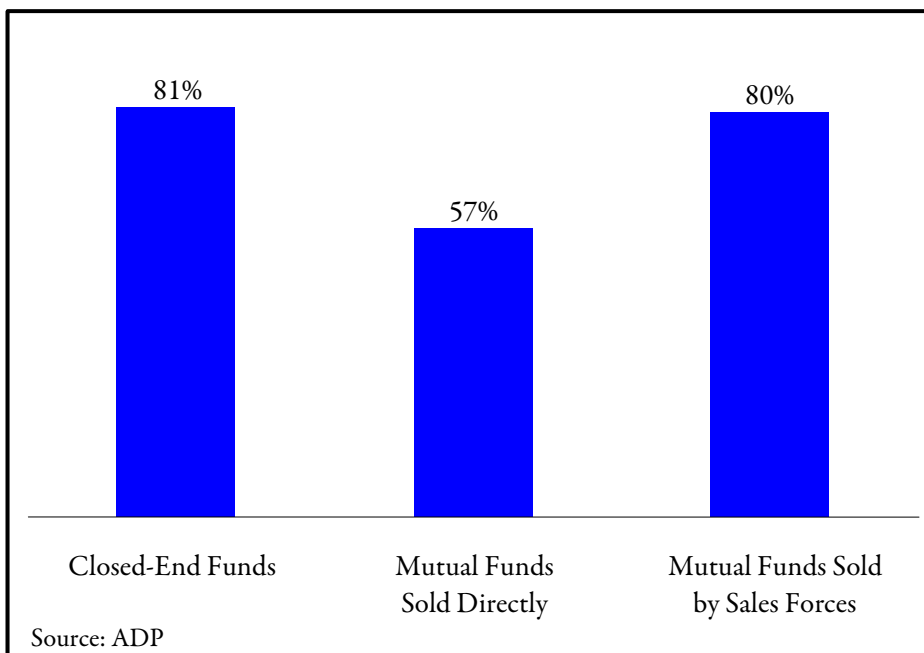


substantial portion of their shares is held in “street name.”<sup>5</sup> ADP estimated that street holdings of closed-end fund shares ranged from a minimum of close to 70 percent to a maximum of 100 percent. Half of closed-end funds had at least 81 percent of their total outstanding shares held in street name (Figure 2).

Mutual funds also have a significant portion of their shares held in street name. For mutual funds sold via sales forces (either proprietary or non-proprietary), shares held in street name ranged from 78 percent to 100 percent of total fund shares, with a median of 80 percent—similar to that of closed-end funds. Even mutual funds that are marketed directly to investors had a considerable amount of their shares held in street name. As shown in Figure 2, half of mutual funds sold directly had at least 57 percent of total shares outstanding held in street name. Direct-sold mutual funds often are offered on platforms or supermarkets, and these shareholder accounts generally are held in street name.

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**Figure 2**  
Percent of Fund Shares Held in Street Name  
Median



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<sup>5</sup> “Street name” is used to identify accounts held by banks and brokers in nominee name on behalf of the beneficial owners. Not all banks and brokers are NYSE members, and ADP was unable to separate NYSE members from non-NYSE members in their analysis. We believe, however, that the majority of banks and brokers with accounts held in street name are NYSE members and that ADP’s results provide a reasonable assessment of NYSE members’ holdings of fund shares.

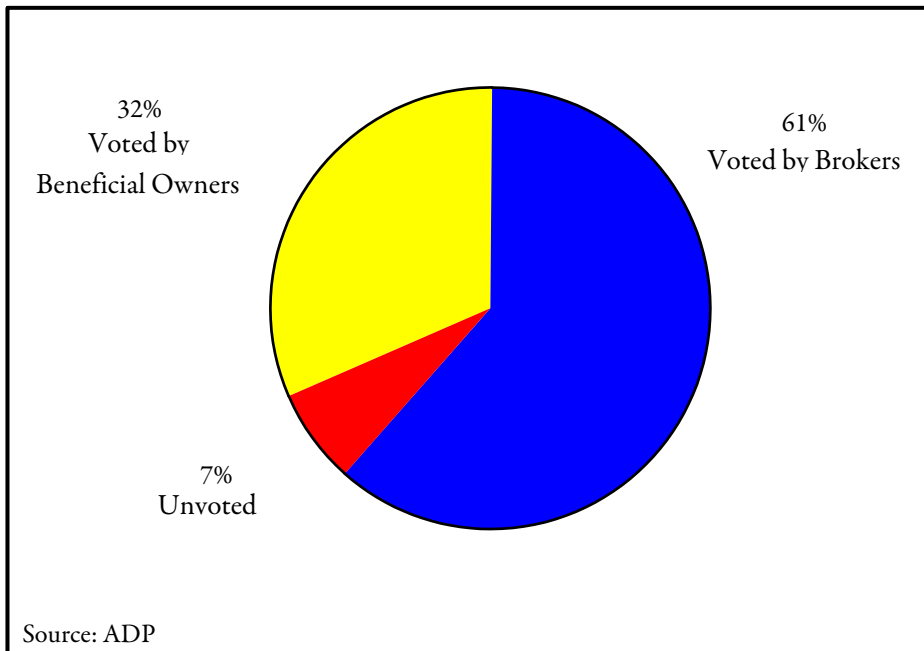
## BENEFICIAL OWNERS OF FUND SHARES HELD IN STREET NAME RETURN PROXIES AT A FAIRLY LOW RATE

Another factor that affects the cost of eliminating discretionary broker voting is the voting response by beneficial owners. The more apt voters are to vote on the first solicitation of the proxy, the less costly it will be to eliminate discretionary broker voting. Beneficial owners of fund shares held in street name, however, return their proxies at a fairly low rate on routine items. Based on data collected by the Institute, the quorum requirement for a little over 60 percent of shareholder meetings pertaining to an election of directors was a **majority** of outstanding shares. Consequently, in an uncontested election of directors, discretionary broker voting is often important for funds to achieve a quorum.

Based on ADP's analysis of voted proxies across both closed-end funds and mutual funds, beneficial owners for half of the funds voted on routine matters at most 32 percent of their shares held in street name (Figure 3). When brokers were allowed to vote, their votes accounted for at least 61 percent of shares held in street name for half of the funds. Overall, half of funds had at least 93 percent of street-held shares voted when discretionary broker voting was allowed.

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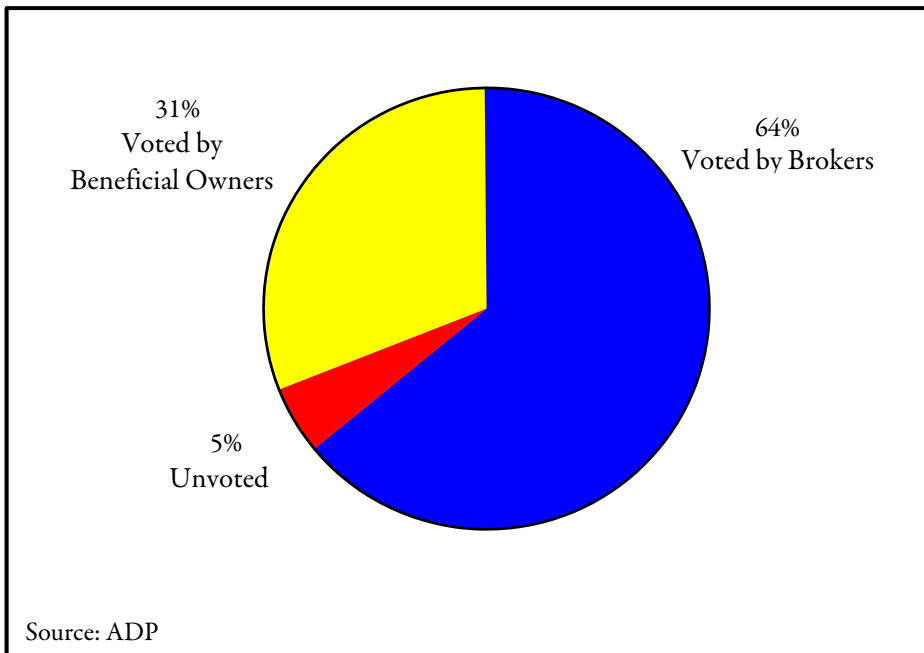
**Figure 3**  
All Funds  
Percent of Fund Shares Held in Street Name  
Median



Even though closed-end fund shareholders are solicited annually by their funds to elect directors, many shareholders still do not vote. As shown in Figure 4, for half of closed-end funds, beneficial owners voted at most 31 percent of their shares held in street name. Shares voted by brokers for half of closed-end funds accounted for at least 64 percent of shares held in street name. As a result, for half of closed-end funds, at least 95 percent of shares held in street name were voted when brokers voted.

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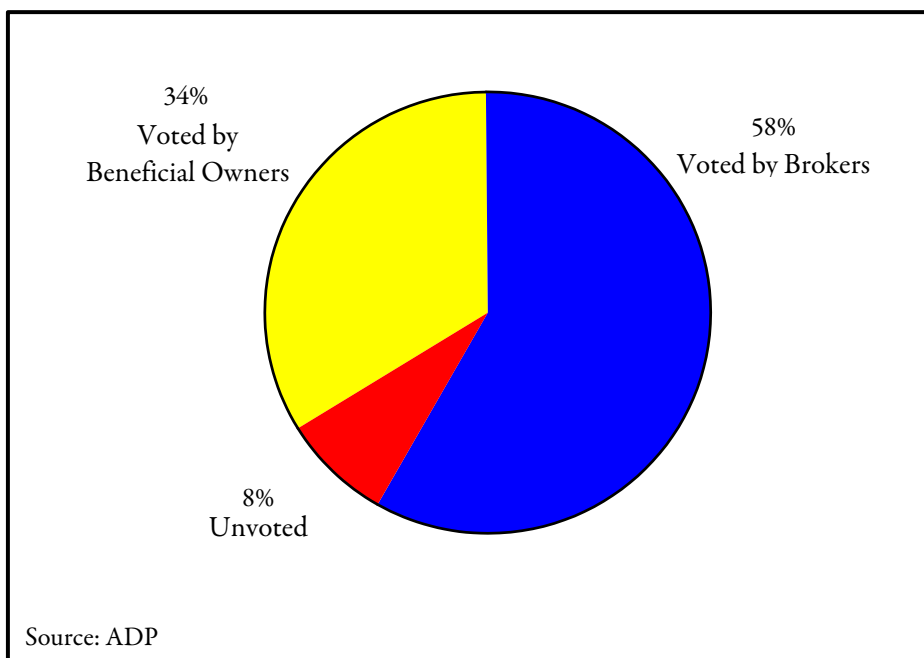
**Figure 4**  
Closed-End Funds  
Percent of Fund Shares Held in Street Name  
Median



For mutual funds, most beneficial owners of shares also do not vote. For half of mutual funds, beneficial owners' votes on routine matters accounted for at most 34 percent of shares held in street name (Figure 5). Shares voted by brokers for half of mutual funds accounted for at least 58 percent of shares held in street name. For half of mutual funds, at least 92 percent of street-held shares were voted when brokers were allowed to vote.

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**Figure 5**  
**Mutual Funds**  
Percent of Fund Shares Held in Street Name  
Median



By way of example, we considered the typical situation facing a closed-end fund with a majority quorum requirement. The average closed-end fund has about 80 percent of its shares held in street name and 20 percent held directly—nearly all of the fund's shares are held by retail investors. We know from ADP that beneficial owners typically vote 31 percent of their street-held shares.<sup>6</sup> As a result, a closed-end fund can expect beneficial owners with shares held in street name to vote one-quarter ( $.80 \times .31$ ) of its outstanding total shares. Even if the closed-end fund could obtain votes from all of its remaining 20 percent of shares outstanding, the fund would only have a total of 45 percent of its outstanding shares voted—25 percent from

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<sup>6</sup> This typical voting response by beneficial owners is likely representative of the response to an initial solicitation for an uncontested election of directors because ratification of auditors—the only other routine matter—is rarely presented for vote to fund shareholders.

beneficial owners of shares held in street name and 20 percent from direct investors. Consequently, the typical closed-end fund would fall short of a majority quorum in an uncontested election of directors without discretionary broker voting and without undertaking additional measures to solicit votes of beneficial owners.

Mutual funds, which also tend to have a significant percentage of their shares held in street name and have similar voting responses by beneficial owners, will face comparable difficulties in achieving quorum if discretionary broker voting is eliminated for uncontested elections of directors. For mutual funds, these difficulties in reaching quorum will be heightened if the SEC adopts its proposal to increase the required percentage of independent directors on mutual fund boards to 75 percent. As noted in the Institute's comment letter on the proposal, mutual funds are likely to need more frequent shareholder meetings for the election of directors because the board will have less flexibility to adjust to director turnover.<sup>7</sup>

#### **FUNDS CANNOT COMMUNICATE DIRECTLY WITH SOME SHAREHOLDERS**

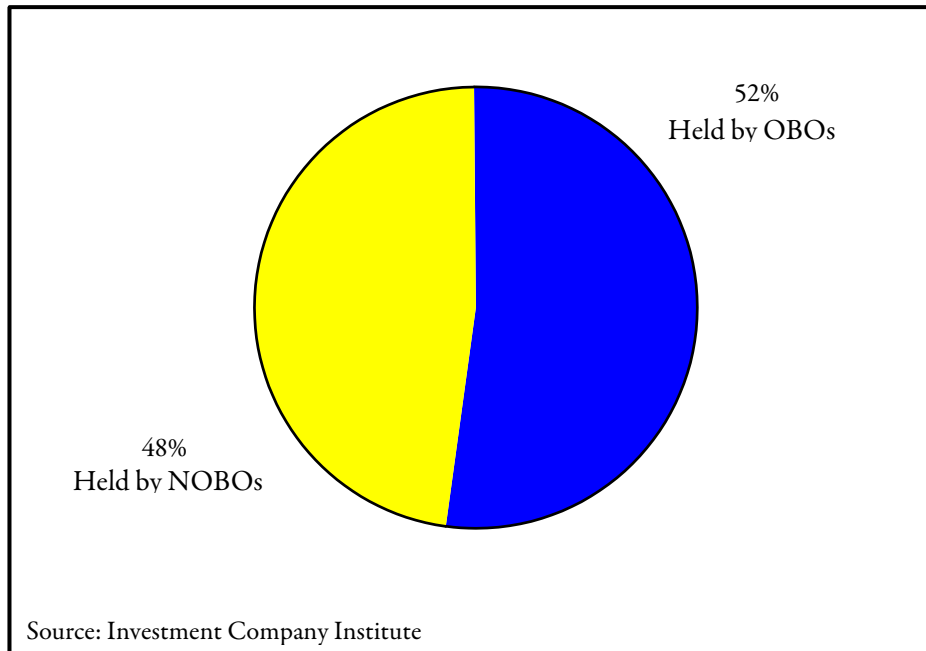
One of the challenges for funds in obtaining a quorum in the absence of discretionary broker voting is that in many cases they are prohibited from communicating directly with shareholders. Brokers invite their customers to choose whether closed-end funds, mutual funds, and other issuers whose shares they own may contact them. Based on ADP's analysis, for half of funds, at least 52 percent of shares held in street name are owned by shareholders who have indicated that issuers cannot contact them (Figure 6). Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs." SEC rules prohibit banks and brokers from providing funds with the names of OBOs. Shareholders who do not object to having their names and addresses given to issuers are called "Non-Objecting Beneficial Owners" or "NOBOs."

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<sup>7</sup> See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, Securities Exchange Commission, dated August 21, 2006.

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**Figure 6**  
All Funds  
Percent of Fund Shares Held in Street Name  
Median



Half of funds—those with a minority of their shareholders classified as NOBOs—have a limited pool of shareholders from whom they are allowed to solicit proxy votes over the phone. When funds are uncertain of obtaining a quorum, they encourage shareholders to vote via follow-up mailings or phone solicitation. While all shareholders receive reminder mailings,<sup>8</sup> at times, more intensive efforts are necessary for funds to obtain quorum. In these cases, funds often will focus their energies on NOBO shareholders. NOBOs can be contacted by either the fund or by a third-party proxy solicitor to obtain their votes over the phone.<sup>9</sup>

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<sup>8</sup> ADP sends reminder mailings to OBOs. Funds, third-party proxy solicitors, or ADP send reminder mailings to NOBOs.

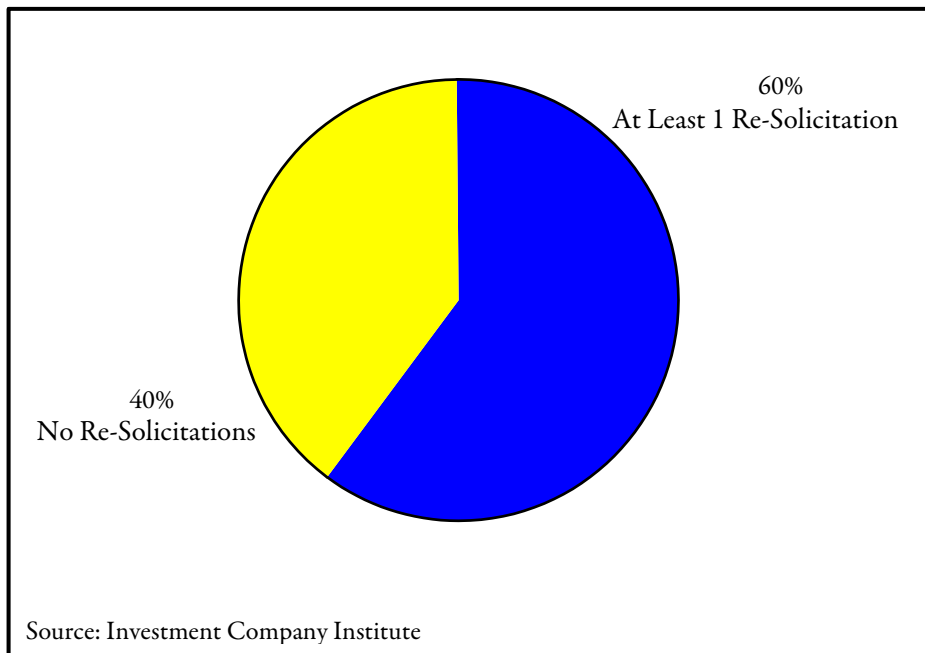
<sup>9</sup> Although phone solicitation is quite costly, some funds incur the expense to avoid the disruption caused by an adjournment of a shareholder meeting.

## RE-SOLICITATIONS AND ADJOURNMENTS OF FUND SHAREHOLDERS WILL INCREASE

If discretionary broker voting is eliminated for uncontested elections of directors, funds can expect to re-solicit shareholders and adjourn shareholder meetings at a higher frequency. Based on the Institute's survey, not a single shareholder meeting with only routine matters, such as an uncontested election of directors and/or ratification of auditors, on the slate required a re-solicitation of shareholders or was adjourned for lack of quorum. This result is expected because of the high rate at which brokers vote. In contrast, nearly 60 percent of shareholder meetings that contained at least one non-routine matter required at least one re-solicitation of shareholders (Figure 7).

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**Figure 7**  
Re-Solicitations of Shareholder Meetings With at Least One Non-Routine Matter

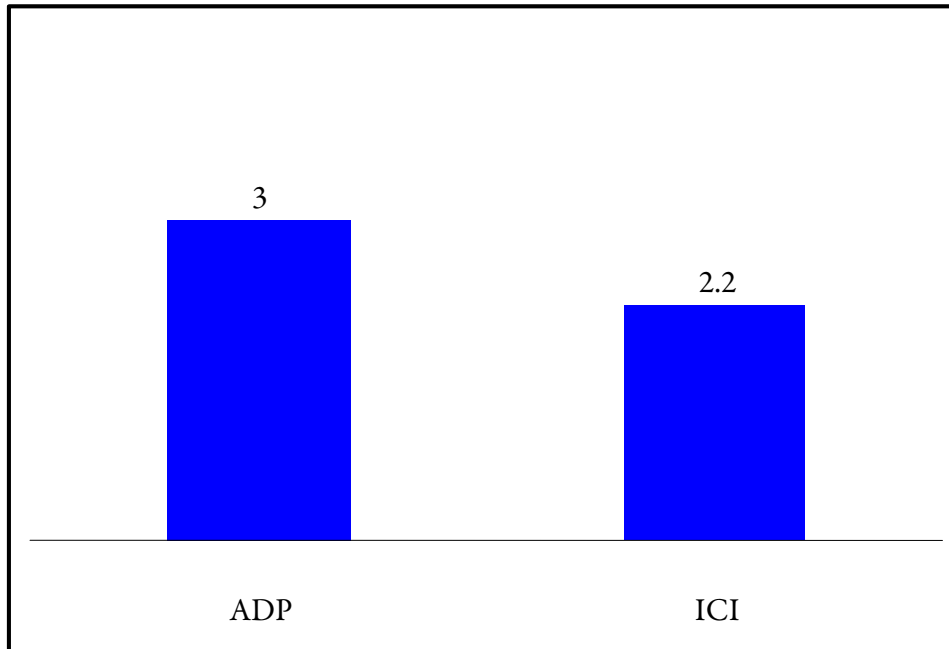


Funds that must re-solicit shareholders can expect, on average, to have to contact shareholders between 2 to 3 times to obtain quorum. Tabulations by both ADP and the Institute are reasonably consistent with one another (Figure 8). The maximum number of re-solicitations in the Institute's survey was 5 re-solicitations of shareholders.

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**Figure 8**

Average Number of Re-Solicitations of Shareholders

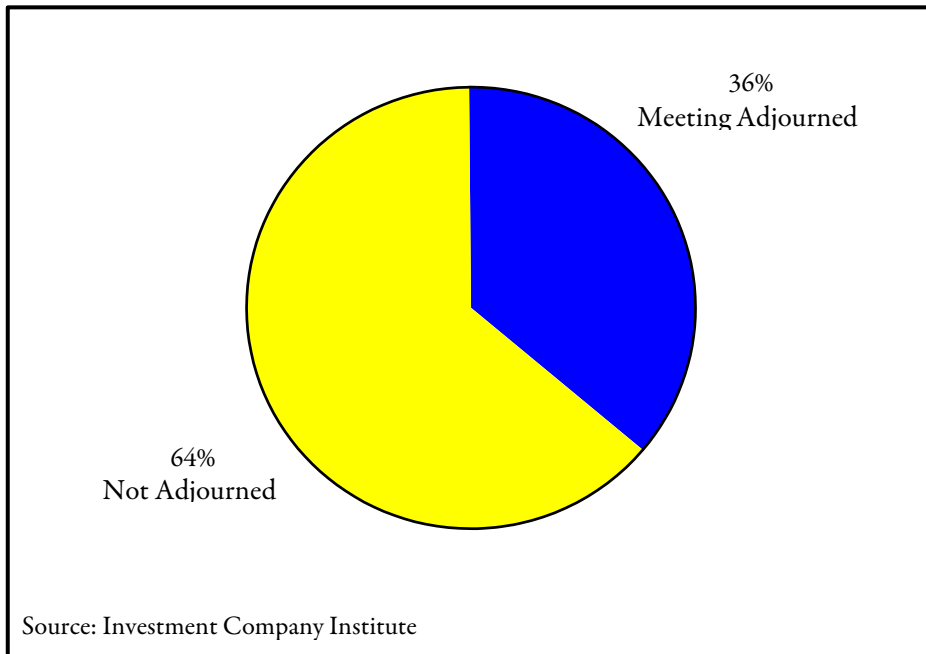




Despite re-solicitation efforts, some funds needed to adjourn shareholder meetings due to insufficient voting response by shareholders. Based on the Institute's survey, a little more than one-third of shareholder meetings with at least one non-routine matter were adjourned (Figure 9).

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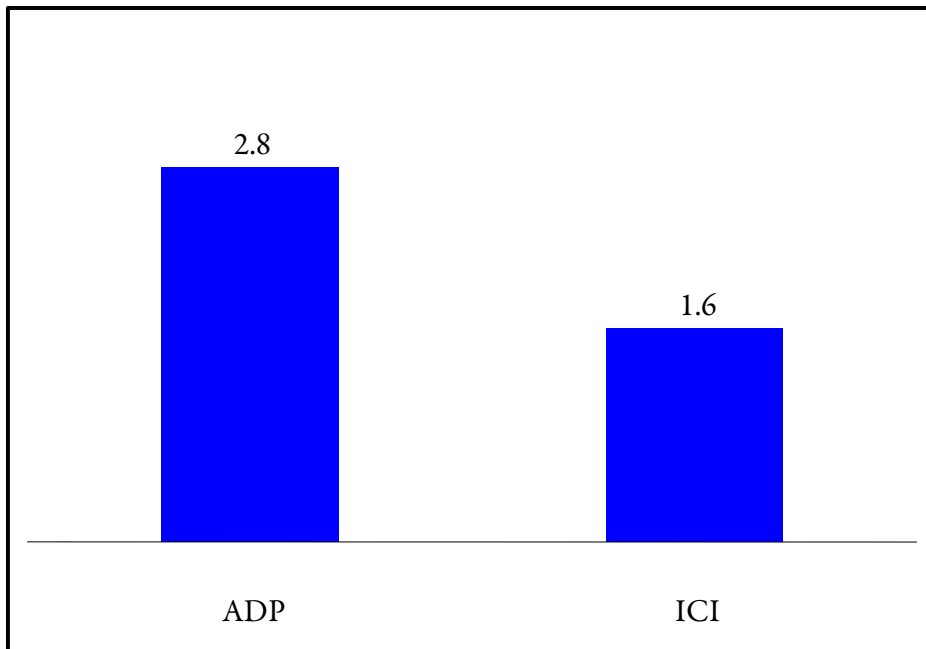
**Figure 9**  
Adjournments of Shareholder Meetings With at Least  
One Non-Routine Matter



Funds that must adjourn shareholder meetings can expect, on average, to adjourn roughly between 2 to 3 times. As shown in Figure 10, tabulations by both ADP and the Institute again are reasonably consistent with one another. In ADP's analysis, one fund experienced a maximum of 17 adjournments of a shareholder meeting. The Institute's survey had a maximum of 5 adjournments of a shareholder meeting.

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**Figure 10**  
Average Number of Times Shareholder Meetings Were Adjourned



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## Impact on Fund Industry from Eliminating Discretionary Broker Voting

We assessed the impact on the fund industry from eliminating discretionary broker voting by:

- Estimating the increase in proxy costs for funds based on the typical voting response by fund shareholders under routine and non-routine scenarios;
- Estimating increases in fund expense ratios based on a range of voting responses by fund shareholders under a non-routine scenario; and
- Analyzing the competitive effect on small fund advisers.

### PROXY COSTS FOR FUNDS WILL RISE SUBSTANTIALLY

If brokers are not permitted to exercise discretionary voting authority on uncontested elections of directors, we estimate that typical proxy costs will more than double from \$1.65 per shareholder account to \$3.68 per shareholder account (Figure 11). In order to assess the impact of eliminating discretionary broker voting, we examined proxy costs in two scenarios. The baseline scenario, which we call “Routine,” is one in which all items on the shareholder agenda are routine and brokers are allowed to vote.<sup>10</sup> The other scenario, which we call “Non-Routine,” is when there is at least one non-routine item on the shareholder meeting slate.<sup>11</sup> For ease of comparison, we scaled the proxy costs by shareholder accounts.<sup>12</sup> More detailed results of our analysis are shown in Table 1.

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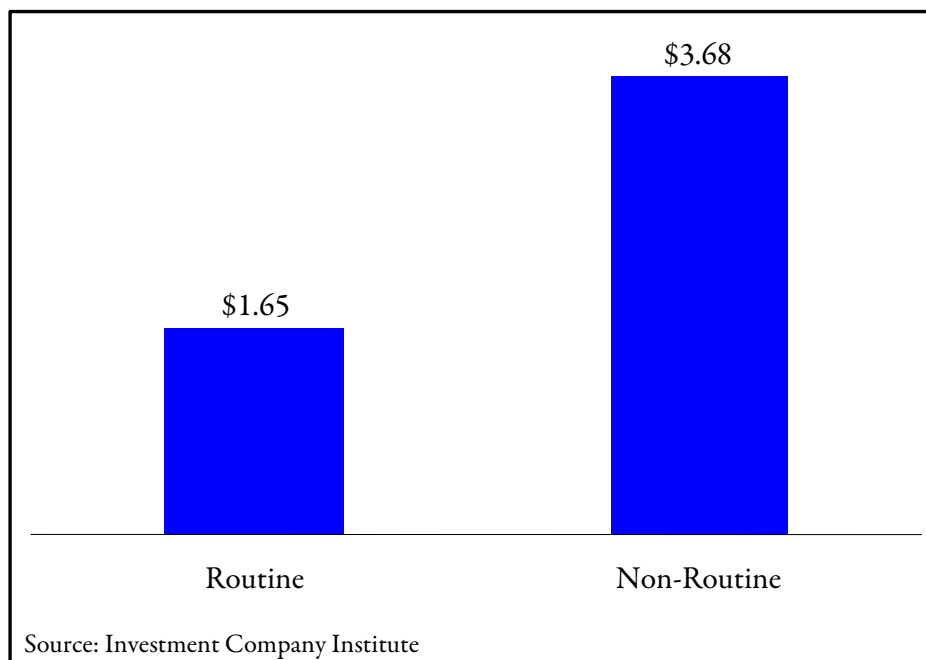
<sup>10</sup> Based on the Institute’s survey, shareholder meetings with a routine slate are fairly common. Roughly one-third of the 105 shareholder meetings had a routine slate. In nearly all of the routine meetings, shareholders were voting on the election of directors.

<sup>11</sup> The results are little changed if we only examine shareholder meetings in which all items on the shareholder agenda are non-routine. The presence of even one non-routine matter on the shareholder agenda significantly increased proxy costs.

<sup>12</sup> We derived cost estimates per shareholder account by looking through street holdings to the number of accounts held by beneficial owners. When possible, ADP provided the number of proxy items mailed—a good indicator of the number of shareholder accounts when ADP handled the entire proxy solicitation. The ADP figures also took into consideration householding, a common practice used to reduce mailing costs by bundling multiple proxy materials that are sent to a single address. When figures from ADP were unavailable or ADP did not handle the entire proxy solicitation, we used confidential data submitted to ICI on number of shareholder accounts by share class for mutual funds. We also examined the number of shareholder accounts reported on Form N-SAR filed with the SEC. If we found that we still did not have an accurate measure of shareholder accounts, we eliminated the proxy costs associated with those accounts from the analysis.

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**Figure 11**  
Fund Proxy Costs Per Shareholder Account  
Median



Given the difficulties that funds face in obtaining votes from shareholders, funds often engage a third-party proxy solicitor to strategize timing, mailing, and phone follow-ups to help funds achieve a quorum. The Institute’s survey collected all-in proxy costs for shareholder meetings. These proxy costs included charges for printing, mailing, and any services provided by proxy solicitors hired by the fund. We believe that the fund complexes that completed the Institute’s survey are representative of the industry’s experience with proxy voting by shareholders. As shown in Figures 8 and 10, ICI and ADP’s figures on average number of re-solicitations and adjournments were quite comparable.

Several factors, all of which stem from shareholders’ failure to vote, contribute to the increased proxy costs for Non-Routine shareholder meetings. One factor that can add up to \$0.60 cents per item mailed is that funds frequently will send proxy materials that contain non-routine matters to shareholders via first class mail rather than at the cheaper bulk rate.<sup>13</sup> First

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<sup>13</sup> Many funds send proxy materials with only routine items to shareholders at bulk rate, which depending on the weight of the package can be considerably less expensive than first class mail. For example, a one-page letter with a proxy postcard typically costs \$0.28 to mail at the bulk rate. The same package typically costs \$0.87 to mail at the first class rate. We do not have data on the frequency with which fund shareholders have consented to receive proxy materials electronically. For those shareholders that have opted for e-delivery, proxy solicitation costs would be less than for those who receive materials by regular mail.

class mail is faster than bulk mail. Understandably, many funds seek to take advantage of the full proxy period before the shareholder meeting so that if re-solicitations are necessary there will be sufficient time to avoid an adjournment.

Re-soliciting shareholders to encourage them to vote is expensive.<sup>14</sup> Besides sending additional mailings at the first class rate, funds may re-send proxy materials to shareholders by overnight delivery in an effort to obtain their vote by the deadline. Proxy costs escalate when funds have to use phone solicitation to persuade shareholders to vote. For example, one fund in the Institute’s survey had a maximum of \$9.97 per shareholder account in proxy costs (Table 1). For this fund, phone solicitation accounted for 44 percent of its total proxy costs of approximately \$172,000.

In addition, funds can spend far more than expected on proxy solicitations. One major fund complex that conducted a complex-wide proxy solicitation estimated total proxy costs of \$5.2 million in their definitive proxy material filings with the SEC. After 4 re-solicitations of shareholders and 2 meeting adjournments, proxy costs ultimately amounted to \$19.2 million—3.7 times the original estimate.

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**Table 1**  
Fund Proxy Costs Per Shareholder Account

	<b>Routine</b>	<b>Non-Routine</b>
Minimum	\$0.95	\$1.12
25 <sup>th</sup> Percentile	\$1.27	\$2.76
<b>Median</b>	<b>\$1.65</b>	<b>\$3.68</b>
75 <sup>th</sup> Percentile	\$2.39	\$5.54
Maximum	\$3.42	\$9.97
<b>Mean</b>	<b>\$1.85</b>	<b>\$4.37</b>
Number of Meetings	26	57
Source: ICI calculations based on proxy costs from ICI Survey of Shareholder Voting and number of shareholder accounts from ADP, N-SAR, and confidential internal ICI data.		

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<sup>14</sup> Even if the OBO/NOBO distinction were eliminated, allowing funds to contact all of their shareholders directly “to get out the vote,” re-solicitations still would be costly.

## MANY SHAREHOLDERS WILL PAY MORE IN FUND EXPENSE RATIOS

Ultimately, fund shareholders will bear much of the burden of increased proxy solicitation costs. Fund expense ratios will increase if discretionary broker voting is disallowed for uncontested elections of directors, and if no other component of fund expenses declines. Typically, funds pay proxy costs, particularly for the election of directors, as part of the fund's total expenses.<sup>15</sup>

We conservatively estimate that fund expense ratios typically will rise between 1 to 2 basis points if funds have to change the treatment of an uncontested election of directors from a routine matter to a non-routine matter. For equity mutual funds, their expense ratios could increase as much as 5 basis points or more. In Tables 2 through 4, we provide a range of outcomes for the estimated increase in fund expense ratios for closed-end funds, equity mutual funds, and bond mutual funds.

In each case, the amount of the anticipated increase in the expense ratio of a given fund depends on two key factors: (1) the average account size; and (2) the amount of the increase in proxy costs per account. In short, the increase in the expense ratio will be larger when average account sizes are smaller and the increase in proxy costs is higher.

In the example provided below, we describe the calculation that is the basis for each of the figures shown in Tables 2 through 4. Closed-end fund shareholders typically pay about 117 basis points in fees and expenses.<sup>16</sup> For an average account size of \$22,000, this translates into \$257.40 in fees and expenses each year.<sup>17</sup> Closed-end funds are required to hold annual shareholder meetings in which they must elect the board of directors. Often, this is the only matter presented for shareholder approval. Consequently, current total fees and expenses of a closed-end fund most likely include proxy costs under a Routine scenario, which we estimate to be a median of \$1.65 per shareholder account. If discretionary broker voting for uncontested elections of directors is disallowed, we estimate that the median proxy cost will increase to \$3.68 per shareholder account. To assess the impact of this proposal on the expense ratio, we recalculated total fees and expenses under a Non-Routine scenario, holding management fees and other expenses constant. In this case, fees and expenses increase to \$259.43 per year, pushing up the asset-weighted average annual expense ratio by nearly 1 basis point.

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<sup>15</sup> These proxy costs are generally included in the fund's annual operating expenses under the category "Other Expenses" listed on Form N-1A filed with the SEC. Occasionally, the fund's adviser will assume all or part of the proxy costs. In some instances, the sub-adviser will assume the proxy costs for the approval of a new sub-advisory agreement.

<sup>16</sup> To assess the costs investors currently pay across all closed-end funds, we used the asset-weighted average expense ratio for all closed-end funds.

<sup>17</sup>  $\$22,000 \times 0.0117 = \$257.40$ .

### **Example**

Closed-end funds

Asset-weighted expense ratio = 117 basis points<sup>18</sup>

Average account size = \$22,000<sup>19</sup>

	<b>ROUTINE</b>	<b>NON-ROUTINE</b>
Management Fees & Other Expenses	\$255.75	\$255.75
Proxy Costs	<u>\$1.65</u>	<u>\$3.68</u>
Total Fees & Expenses	\$257.40	\$259.43

Expense ratio under non-routine scenario =  $(\$259.43/\$22,000)*10,000 = 117.9$  basis points.

Change in the expense ratio =  $117.9 - 117 = 0.9$  basis point.

As noted above, this calculation depends on the average account size and the amount of the increase in proxy costs. In the example shown above, the average account size of \$22,000 was from one large closed-end fund complex. Other closed-end funds may have smaller or larger average account sizes.<sup>20</sup> For demonstration purposes, let's assume that one-quarter of closed-end funds have average account sizes of \$11,000 (one-half of the \$22,000), and one-quarter of closed-end funds have average account sizes of \$44,000 (double the \$22,000).

As shown in Table 2, for closed-end funds with an \$11,000 average account balance, shareholders can expect the expense ratios of their fund to rise between 1 to 3.5 basis points. This range reflects the varying degrees of shareholder response in voting their proxies. If shareholders vote fairly readily, they likely will incur a \$2.76 per account charge (the 25<sup>th</sup> percentile cost of a Non-Routine proxy), which would increase the fund's annual expense ratio by one basis point. However, if greater efforts such as phone solicitations and multiple mailings are required to obtain shareholder votes, then shareholders could easily incur a \$5.54 (the 75<sup>th</sup> percentile cost of a Non-Routine proxy) or more per account charge, which would increase the fund's expense ratio by at least 3.5 basis points.

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<sup>18</sup> Figure based on ICI calculations of expense data for 2005 from Strategic Insight Simfund 4.0 database.

<sup>19</sup> Figure based on calculation from a large closed-end fund complex.

<sup>20</sup> Research conducted by the Institute in 1998 indicated that the median amount of household financial assets held in closed-end funds was \$12,000, while the average was \$41,500 (ICI Fundamentals, U.S. Household Ownership of Closed-End Fund in 1998, April 1999).

**Table 2**

Range of Estimated Increase in Expense Ratios from Eliminating Discretionary  
Broker Voting

Closed-End Funds

Asset-Weighted Expense Ratio = 117 basis points<sup>1</sup>

Non-Routine Proxy Costs Per Account <sup>2</sup>	Average Shareholder Account Size		
	\$11,000	\$22,000 <sup>3</sup>	\$44,000
\$2.76	+1.0 bp	+0.5 bp	+0.3 bp
\$3.68	+1.8 bp	<b>+0.9 bp</b>	+0.5 bp
\$5.54	+3.5 bp	+1.8 bp	+0.9 bp

1. Figure based on ICI calculations of expense data for 2005 from Strategic Insight Simfund 4.0 database.  
2. Figures are the 25<sup>th</sup> percentile, median, and 75<sup>th</sup> percentile of proxy costs per shareholder account of a non-routine slate from Table 1.  
3. Figure based on a calculation from a large closed-end fund complex.

Equity mutual fund shareholders typically pay 90 basis points in fees and expenses. Our analysis suggests that, for half of equity mutual funds, expense ratios are likely to increase by 1.8 basis points when they are required to elect a board of directors without discretionary broker voting (Table 3). For one-fourth of equity mutual funds with average account balances of \$7,400 or less, expense ratios could increase by a little more than 5 basis points if shareholders are more apathetic about voting. For one-fourth of equity mutual funds with average account balances of at least \$17,600, expense ratios are expected to increase anywhere from 0.6 basis points to 2.2 basis points, depending on shareholder voting responses.

**Table 3**

Range of Estimated Increase in Expense Ratios from Eliminating Discretionary  
Broker Voting

Equity Mutual Funds<sup>1</sup>

Asset-Weighted Expense Ratio = 90 basis points<sup>2</sup>

Non-Routine Proxy Costs Per Account <sup>3</sup>	Average Shareholder Account Size <sup>4</sup>		
	\$7,400	\$11,600	\$17,600
\$2.76	+1.5 bp	+1.0 bp	+0.6 bp
\$3.68	+2.7 bp	<b>+1.8 bp</b>	+1.2 bp
\$5.54	+5.3 bp	+3.4 bp	+2.2 bp

1. Includes hybrid mutual funds.  
2. Figure based on ICI calculations using expense data by share class for 2005 from Lipper LANA 4.0 database.  
3. Figures are the 25<sup>th</sup> percentile, median, and 75<sup>th</sup> percentile of proxy costs per shareholder account of a non-routine slate from Table 1.  
4. Figures are the 25<sup>th</sup> percentile, median, and 75<sup>th</sup> percentile of ICI calculations of the average account size by fund from account level data in non-variable annuity retail equity and hybrid mutual funds collected by ICI.



These expected increases in equity mutual fund expense ratios from eliminating discretionary broker voting are about on par with the cost of custody services and audit fees paid by many equity mutual funds.<sup>21</sup> For example, half of equity mutual funds have custody fees that account for at least 2½ basis points on their expense ratios. Custody fees range from at most 1 basis point for one-quarter of equity mutual funds to at least 6 basis points for another quarter of equity mutual funds. Half of equity mutual funds have audit fees that account for at least 1½ basis points on their expense ratios. Audit fees range from at most ½ basis point for one-quarter of equity mutual funds to at least 4 basis points for another quarter of equity mutual funds.

Shareholders of bond mutual funds typically pay 70 basis points in fees and expenses. Our analysis suggests that, for half of bond mutual funds, expense ratios are likely to increase by 1.4 basis points when they are required to elect a board of directors without discretionary broker voting (Table 4). For one-fourth of bond mutual funds with average account balances of \$10,400 or less, expense ratios could increase by as much as 3.7 basis points. For one-fourth of bond mutual funds with average account balances of at least \$19,600, expense ratios are expected to increase anywhere from 0.6 basis points to 2 basis points, depending on shareholder voting responses.

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**Table 4**  
**Range of Estimated Increase in Expense Ratios from Eliminating Discretionary Broker Voting**  
**Bond Mutual Funds**  
 Asset-Weighted Expense Ratio = 70 basis points<sup>1</sup>

Non-Routine Proxy Costs Per Account <sup>2</sup>	Average Shareholder Account Size <sup>3</sup>		
	\$10,400	\$14,400	\$19,600
\$2.76	+1.1 bp	+0.8 bp	+0.6 bp
\$3.68	+2.0 bp	<b>+1.4 bp</b>	+1.0 bp
\$5.54	+3.7 bp	+2.7 bp	+2.0 bp

1. Figure based on ICI calculations using expense data by share class for 2005 from Lipper LANA 4.0 database.  
 2. Figures are the 25<sup>th</sup> percentile, median, and 75<sup>th</sup> percentile of proxy costs per shareholder account of a non-routine slate from Table 1.  
 3. Figures are the 25<sup>th</sup> percentile, median, and 75<sup>th</sup> percentile of ICI calculations of the average account size by fund from account level data in non-variable annuity retail bond mutual funds collected by ICI.

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<sup>21</sup> The following figures are ICI calculations using data from Strategic Insight Simfund 4.0 MF database.

## **SMALL FUND ADVISERS WILL BEAR A SIGNIFICANT BURDEN<sup>22</sup>**

Small fund advisers are likely to bear a significant burden from the elimination of discretionary broker voting for three reasons.

First, economies of scale in additional costs per account work to the disadvantage of small funds. Small funds, even if they conduct complex-wide proxies, are less able to take advantage of volume discounts in printing and mailing because they have fewer shareholders.<sup>23</sup> Thus, on a per-account basis, the additional proxy costs are likely to be higher for small funds compared to large funds.

Second, expense ratios are already higher than average for small funds.<sup>24</sup> Even higher expense ratios are likely to make these funds less attractive to potential and existing shareholders, leading them to seek out lower cost funds.<sup>25</sup> To avoid increasing expense ratios, small fund advisers often pay costs out of their own pockets that typically are charged to a fund. Similarly, many small fund advisers enter into expense cap agreements, under which they agree to limit the expenses charged to a fund, paying any excess costs themselves. Advisers may also offer fee waivers. While large and small funds offer fee waivers with similar frequency, the waivers offered by small funds tend to be substantially higher.<sup>26</sup> These practices suggest that, for funds to attract and retain shareholders, there is essentially a market-imposed constraint on their expense ratios.

Finally, because many small fund advisers will feel compelled to absorb additional proxy costs, their profit margins will be squeezed further. Although figures on fund advisers' profitability are unavailable, anecdotal evidence suggests that small fund advisers operate under thin margins. The expected smaller rate of return on capital will dissuade some entrepreneurs from entering the mutual fund industry and push some fund advisers with thin profit margins to exit.

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<sup>22</sup> Small fund advisers are defined as fund complexes with less than \$2 billion in non-money market mutual fund assets.

<sup>23</sup> Many fund complexes combine shareholder meetings of individual funds into one complex-wide proxy to save on printing and distribution costs.

<sup>24</sup> See Appendix B in Letter from Members of Small Funds Committee, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated August 21, 2006.

<sup>25</sup> Investors can and do vote with their feet—in any given year, a quarter to a half of all mutual fund firms experience net outflows from long-term funds. Figure based on confidential data submitted to ICI for the monthly *Trends in Mutual Fund Activity* report.

<sup>26</sup> See Appendix C in Letter from Members of Small Funds Committee, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated August 21, 2006.

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## Appendix

### Investment Company Institute Survey on Shareholder Voting

Confidential Once Completed

July 7, 2006

#### SURVEY INSTRUCTIONS

For each one of the most recent four shareholder meetings held by your complex, please complete the following worksheets: (1) Fund Information for Shareholder Meeting and (2) Matter-Specific Information for Shareholder Meeting. If your complex has had fewer than four shareholder meetings in the past five years, please provide information for all shareholder meetings held in the past five years. Worksheets for four shareholder meetings have been provided for your convenience.

##### *Fund Information for Shareholder Meeting*

For each shareholder meeting, answers to items (4) through (7) may be available from your fund's transfer agent.

##### *Matter-Specific Information for Shareholder Meeting*

For each shareholder meeting, please provide information for all matters presented for a shareholder vote on a matter-by-matter basis. We have provided space for four matters per shareholder meeting. If you require additional space, please make a copy of a blank worksheet and indicate that the information is a continuation of a previous worksheet.

For item (8), please provide a brief description of the matter presented at the shareholder meeting. Some examples would be "election of directors", "approval of advisory contract", or "change in fundamental policies."

Since quorum requirements may vary by matter, please report the quorum requirement used for the specific matter in item (9).

For item (10), please report which one of the four options defined below was used as the standard of voting for the specific matter at the annual or a special shareholder meeting.

1. **Super-Majority:** 67 percent or more of the voting securities present at such meeting, if the holders of more than 50 percent of the outstanding voting securities of such fund are present or represented by proxy.
2. **Majority Vote:** more than 50 percent of the outstanding voting securities of the fund.
3. **Affirmatively Cast:** more than 50 percent of votes affirmatively cast (i.e., abstentions and broker non-votes are not counted in determining whether a majority of votes cast have approved a matter).
4. **Other:** any voting standard that does not fit in the three categories defined above.

For items (11) through (16), your transfer agent may be able to provide the necessary information. Also, items (17) through (19) are critical. Please provide as much information as possible on your number of re-solicitations (e.g., how many mailings), number of adjournments, and proxy solicitation costs.

If you have any questions regarding the survey, please contact Shelly Antoniewicz at (202) 326-5910 or at [rantoniewicz@ici.org](mailto:rantoniewicz@ici.org).

**PLEASE RETURN SURVEY BY JULY 31, 2006.**

Please enter the information into this document and return by electronic mail to Shelly Antoniewicz at [rantoniewicz@ici.org](mailto:rantoniewicz@ici.org) or if you prefer, you can fax the information to her at (202) 326-5924. Thank you for your assistance in this project.

**FIRM INFORMATION AS OF JUNE 30, 2006**

Name of firm: \_\_\_\_\_  
1940 Investment Company Act registered assets (millions of dollars): \_\_\_\_\_  
Number of 1940 Act registrants (trusts/series) filing with the SEC: \_\_\_\_\_  
Total number of funds (portfolios) included in previous answer: \_\_\_\_\_  
Over the past five years, please report for your complex  
(a) Total number of funds that held shareholder meetings: \_\_\_\_\_  
(b) The total number of shareholder meetings held by these funds: \_\_\_\_\_

**CONTACT INFORMATION**

Name of individual filling out survey: \_\_\_\_\_  
Contact phone: \_\_\_\_\_  
Contact email: \_\_\_\_\_

## Fund Information for Shareholder Meeting #1

1. Name of fund: \_\_\_\_\_
2. Type of fund:    Open-end: \_\_\_\_\_    Closed-end: \_\_\_\_\_
3. Date of shareholder meeting: \_\_\_\_\_
4. Number of fund shares outstanding on record date: \_\_\_\_\_
5. Number of shares held by “objecting beneficial owners”\* on record date: \_\_\_\_\_
6. Percent of shareholders that were “objecting beneficial owners” on record date: \_\_\_\_\_
7. Number of shares held in nominee name by NYSE members on record date: \_\_\_\_\_

\* Shareholders who object to having their names and addresses disclosed to issuers are called “Objecting Beneficial Owners” or “OBOs.”

### Matter-Specific Information for Shareholder Meeting #1

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations <sup>1</sup>				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

## Fund Information for Shareholder Meeting #2

1. Name of fund: \_\_\_\_\_
2. Type of fund:    Open-end: \_\_\_\_\_    Closed-end: \_\_\_\_\_
3. Date of shareholder meeting: \_\_\_\_\_
4. Number of fund shares outstanding on record date: \_\_\_\_\_
5. Number of shares held by “objecting beneficial owners” on record date: \_\_\_\_\_
6. Percent of shareholders that were “objecting beneficial owners” on record date: \_\_\_\_\_
7. Number of shares held in nominee name by NYSE members on record date: \_\_\_\_\_

\* Shareholders who object to having their names and addresses disclosed to issuers are called “Objecting Beneficial Owners” or “OBOs.”

### Matter-Specific Information for Shareholder Meeting #2

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations <sup>1</sup>				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.



### Fund Information for Shareholder Meeting #3

1. Name of fund: \_\_\_\_\_
2. Type of fund:    Open-end: \_\_\_\_\_    Closed-end: \_\_\_\_\_
3. Date of shareholder meeting: \_\_\_\_\_
4. Number of fund shares outstanding on record date: \_\_\_\_\_
5. Number of shares held by “objecting beneficial owners” on record date: \_\_\_\_\_
6. Percent of shareholders that were “objecting beneficial owners” on record date: \_\_\_\_\_
7. Number of shares held in nominee name by NYSE members on record date: \_\_\_\_\_

\* Shareholders who object to having their names and addresses disclosed to issuers are called “Objecting Beneficial Owners” or “OBOs.”

### Matter-Specific Information for Shareholder Meeting #3

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations <sup>1</sup>				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

### Fund Information for Shareholder Meeting #4

1. Name of fund: \_\_\_\_\_
2. Type of fund:    Open-end: \_\_\_\_\_    Closed-end: \_\_\_\_\_
3. Date of shareholder meeting: \_\_\_\_\_
4. Number of fund shares outstanding on record date: \_\_\_\_\_
5. Number of shares held by “objecting beneficial owners” on record date: \_\_\_\_\_
6. Percent of shareholders that were “objecting beneficial owners” on record date: \_\_\_\_\_
7. Number of shares held in nominee name by NYSE members on record date: \_\_\_\_\_

\* Shareholders who object to having their names and addresses disclosed to issuers are called “Objecting Beneficial Owners” or “OBOs.”

**Matter-Specific Information for Shareholder Meeting #4**

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations <sup>1</sup>				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

## Appendix B

### **Text of Recommended Language to Include BDCs in Exception for Investment Companies**

Language to be added is underscored

#### **Rule 452. Giving Proxies by Member Organization**

##### **Giving a Proxy to Vote Stock**

##### **.11 When member organization may not vote without customer instructions.**

(19) is the election of directors, provided, however, that this prohibition shall not apply in the case of a company registered under the Investment Company Act of 1940 or an investment company that elects to be regulated as a business development company under the Investment Company Act of 1940; or