

August 17, 2009

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

Re: Facilitating Shareholder Director Nominations (File No. S7-10-09)

Dear Ms. Murphy:

The Investment Company Institute¹ appreciates the opportunity to provide its views on the Securities and Exchange Commission's recent proposal to facilitate shareholders' ability to nominate company directors.² Investment companies are both shareholders of the companies in which they invest and issuers with their own directors and shareholders. Accordingly, we fully recognize the importance of effective corporate governance and also are cognizant of the need to avoid undue interference with a company's directors and officers who are responsible for its management. We believe there is a need to carefully balance these interests when addressing shareholder access to company proxy materials.³

¹ 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 the ICI manage total assets of \$10.5 trillion and serve over 93 million shareholders.

² See SEC Release Nos. 33-9046; 34-60089; IC-28765 (June 10, 2009), 74 FR 29024 (June 18, 2009) ("Release").

³ The Institute commented on prior Commission proposals regarding proxy access. See Letter from Karrie McMillan, General Counsel, Investment Company Institute to Nancy M. Morris, Secretary, United States Securities and Exchange Commission, dated October 2, 2007 ("2007 ICI Letter"); and Letter from Amy B.R. Lancellotta, Senior Counsel, Investment Company Institute to Mr. Jonathan G. Katz, Secretary, United States Securities and Exchange Commission, dated December 22, 2003 ("2003 ICI Letter"). The Institute also testified on the Commission's 2007 proposal. See Statement of Paul Schott Stevens, President and CEO, Investment Company Institute, on SEC Proxy Access Proposals: Implications for Investors, Before the Committee on Financial Services, United States House of Representatives (September 27, 2007) ("2007 ICI Testimony").

The Commission's proposal has far reaching implications for the relationship between public companies and their shareholders. In general, we believe that the public interest will be served by allowing shareholders who meet appropriate eligibility criteria to submit bylaw amendments concerning director nomination procedures on a public operating company's proxy statement. Long-term shareholders with a significant stake in a company have a legitimate interest in having a voice in the company's corporate governance procedures. Institute members, like other institutional investors, use a variety of methods to enhance shareholder value. The ability to submit bylaw amendments concerning director nomination procedures could prove to be a useful additional tool for this purpose.

Importantly, the ability to gain access to a company's proxy statement should not be so unfettered as to permit shareholders to use the company's proxy machinery to further parochial or short-term interests that are not shared by the company's other shareholders. Care therefore should be taken to craft a regulatory framework in a way that helps to assure that the interests of shareholder proponents are aligned with those of long-term shareholders. To help achieve this goal, we recommend that only shareholders (or groups of shareholders) who own 5 percent or more of a company's securities for at least one year be permitted to submit bylaw amendments regarding director nomination procedures.

We further recommend that the Commission not adopt proposed Rule 14a-11 at this time. Requiring all public companies to permit shareholders to use the company's proxy machinery to nominate directors would force implementation of a dramatic change through a one-size-fits-all approach. Instead, the Commission first should permit shareholders and company management to work together to tailor companies' governing documents through bylaw amendments to suit the specific interests of the company and its shareholders. This approach also will have the benefit of acknowledging and building upon developments in state law regarding proxy access. However, if the Commission determines to go forward with adopting Rule 14a-11, we recommend that only shareholders (or groups of shareholders) of operating companies who own at least 10 percent of a company's securities for at least two years be permitted to nominate directors on a company's proxy statement.

As proposed, the Commission's sweeping new proxy access requirements would apply to investment companies. Yet disappointingly, the Release provides no indication that the Commission has analyzed the need for proxy access requirements for investment companies or, if there is such a need, how the requirements should work. The current proposal does not account for the most prevalent types of investment company boards—unitary or cluster boards—or for other important differences between investment companies and operating companies. In addition, it does not appear that the Commission sufficiently considered investment companies when conducting empirical analysis in connection with the proposal. Accordingly, we recommend that the Commission exclude

investment companies⁴ from this proposal and instead consider whether a proxy access proposal should apply to investment companies at all, and if so, how it could craft a new proposal better suited to the unique attributes of investment companies.

Our specific comments on the proposal include the following, all of which are discussed in greater detail below:

- Access to the company's proxy statement for shareholder proposals related to bylaw amendments should be limited to shareholders with a significant ownership interest for an extended period of time, and who have acquired shares without the intent of changing or influencing control of the issuer; and
- Direct access to a company's proxy statement for the purpose of nominating directors should not be permitted at this time.
- If the Commission nevertheless chooses to permit direct access to a company's proxy statement to nominate directors:
 - Access to a company's proxy statement should be limited to shareholders who have acquired shares without the intent of changing or influencing control of the issuer;
 - Access should be predicated on a significant ownership interest;
 - All members of a shareholder nominating group should have continuously and beneficially held the company's voting securities for an extended period of time;
 - Companies should be required to include no more than one shareholder nominee;
 - Nominating shareholders should be required to disclose their motivation for nominating a particular candidate;
 - Companies should be permitted to provide shareholders with the ability to vote for the entire company-recommended slate by checking one box; and
 - Nominating shareholders should have liability for their statements, and companies should be shielded from liability for those statements.

⁴ Our recommendation encompasses open-end investment companies, closed-end investment companies, exchange-traded funds ("ETFs"), and business development companies ("BDCs"), which will be referred to collectively as "investment companies" or "funds" in this letter.

- Investment companies should be excluded from any final proxy rules regarding director nominations or related bylaw provisions and the Commission should consider whether to craft a new proposal better suited to the unique operational attributes of investment companies that is grounded in empirical analysis.

I. Proposed Bylaw Amendments under Rule 14a-8

Rule 14a-8, the shareholder proposal rule, currently allows a company to exclude from its proxy statement a shareholder proposal that relates to a nomination or an election for membership on the company's board of directors or a procedure for such nomination or election. Under the proposal, shareholders would be permitted, under certain circumstances, to require companies to include in company proxy materials proposals that would amend, or that request an amendment to, a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided the proposal does not conflict with proposed Rule 14a-11⁵ or applicable state law.

A shareholder proponent would be required to have continuously held at least \$2,000 in market value, or 1 percent, of the company's securities entitled to be voted on the proposal for a period of at least one year prior to submitting the proposal. A proponent could propose binding or non-binding bylaw proposals and could suggest nomination procedures that are less, but not more, stringent than those established by Rule 14a-11. Such a proposal could be excluded if it conflicts with state law.

Investment companies are significant investors in operating companies.⁶ They serve as stewards for the interests of fund shareholders and use a variety of methods to seek to enhance shareholder value. These methods include, among others, voting proxies for the securities funds hold in a manner consistent with the funds' investment objectives and policies and engaging in ongoing dialogue with management of the companies in which they invest. As we have indicated previously, to have in reserve the ability to submit bylaw amendments concerning director nomination procedures could prove to be a valuable additional means for enhancing shareholder value.⁷

The Release requests comment on whether alternative thresholds would be more appropriate for purposes of submitting a shareholder proposal under Rule 14a-8(i)(8). The Commission should not facilitate use of the company's proxy machinery by shareholders who might seek to pursue objectives not shared by the company's other shareholders. We believe that the proposed threshold of \$2,000 in market value, or 1 percent, of the company's securities is far too low and would do just that.

⁵ Rule 14a-11, as discussed more fully in Section II below, would create a federal right for certain shareholders to nominate directors on a company's proxy statement.

⁶ Investment companies hold about 25 percent of the equity securities of U.S. companies.

⁷ See 2007 ICI Testimony.

To help assure that the interests of shareholder proponents are aligned with those of long-term shareholders, we recommend that the Commission require that shareholders be permitted to submit bylaw amendments regarding director nomination procedures only if they own 5 percent or more of a company's securities for at least one year.⁸

Under the proposal, no new disclosures would be required from a shareholder submitting a proposal to amend, or requesting an amendment to, a company's governing documents. We oppose this approach because we believe that the company and the Commission should be provided relevant information about the proponent. In particular, we support the application of disclosure requirements along the lines of those in proposed Rule 14a-19, which would help make known whether proponents are seeking bylaw amendments to serve their own interests or the interests of long-term shareholders.⁹ We also recommend requiring proponents of this type of shareholder proposal to state that they do not hold and have not acquired shares for the purpose of or with the effect of influencing or changing control of the company or to gain more than a limited number of seats on the board. Any shareholder with such intent should use the existing mechanisms under the federal securities laws for mounting a proxy contest and bear the related costs. Further, we recommend that the Commission take steps to make clear that the nominating shareholder, not the company, will have liability for any false or misleading statements in information provided by the shareholder that is then included in the company's proxy statement.

II. Shareholder Director Nominations Under Proposed Rule 14a-11

We oppose, at this time, the proposal to create a federally-mandated right and process for shareholders to nominate directors on a company's proxy statement. While we agree that the Commission should remove impediments in the federal securities laws that prevent a shareholder from recommending changes to a company's bylaws to permit shareholder nominees, the Commission should not additionally establish a uniform national regime for all operating companies. Rather, the Commission should facilitate the ability of shareholders and companies to work together to tailor companies' governing documents to suit the specific interests of the company and the shareholders. This approach has the benefit of accommodating recent state corporate law developments,¹⁰ and

⁸ Based on the Institute's analysis, we estimate that 38 mutual fund complexes had 620 holdings that were 5 percent or more in both the fourth quarter of 2007 and the fourth quarter of 2008 (*i.e.*, a one-year holding period).

⁹ The disclosure requirements for shareholder proponents under Rule 14a-8 should reflect the modifications to Rule 14a-19 discussed in Section II below.

¹⁰ *See, e.g.*, Section 112 of Delaware General Corporation Law (permitting a Delaware corporation to adopt a bylaw that specifies the circumstances under which shareholders would have access to the corporation's proxy materials to nominate directors). *See also Remarks at Conference on Shareholder Rights, the 2009 Proxy Season, and the Impact of Shareholder Activism*, Speech by SEC Commissioner Troy A. Paredes, U. S. Securities and Exchange Commission, dated June 23, 2009; and Release at note 69.

allowing firms to craft their own access regime.¹¹ It also would relieve the Commission from having to devise intricate procedures for implementing access and from having to draw somewhat arbitrary lines to establish eligibility requirements. As a result, we do not believe that the Commission should adopt Rule 14a-11 at this time. If the Commission nevertheless determines to adopt Rule 14a-11, we recommend modifying it as discussed below.

A. Eligibility Requirements

Under the proposal, to be included, a nominee would have to be submitted by a shareholder or group of shareholders (“shareholder proponents”) who: (i) have continuously held for at least one year either 1 percent, 3 percent, or 5 percent of the company’s securities, as applicable,¹² that are entitled to be voted on the election of directors at the shareholder meeting; (ii) intend to hold those securities through the date of the subject election of directors; (iii) did not acquire or hold the securities for the purpose of or with the effect of changing control of the company or to gain more than a limited number of seats on the board; and (iv) make certain disclosures, including about their relationships with the company.

Intent of Ownership. We strongly support the Commission’s proposal to limit access to a company’s proxy statement to shareholder proponents who do not hold or have not acquired shares “for the purpose of or with the effect of changing control of the company or to gain more than a limited number of seats on the board.” This requirement will curb abusive use of a company’s proxy machinery to indirectly mount a proxy contest. We recommend also denying access to the company’s proxy statement to any shareholder proponent who seeks to “influence” control of the issuer. By doing so, proponents who, among other things, seek to make any material changes in the issuer’s business or corporate structure would not be permitted to do so on the company’s proxy statement at the expense of all shareholders.¹³ Our recommended approach is consistent with Rule 13d-1 under the Exchange

¹¹ Companies along with their shareholders may reach different conclusions in particular cases as to the advisability and parameters of proxy access on such considerations as company size, existing corporate governance policies, and investor characteristics.

¹² The minimum ownership thresholds would be tiered based on the size of the company. Shareholders of large accelerated filers (those companies with aggregate worldwide market value of voting and non-voting common equity held by its non-affiliates of \$700 million or more) would be required to own 1 percent of the company’s securities; shareholders of accelerated filers (those companies with aggregate worldwide market value of voting and non-voting common equity held by its non-affiliates of \$75 million or more, but less than \$700 million) would be required to own 3 percent of the company’s securities; and shareholders of non-accelerated filers (companies that do not meet the criteria for large accelerated filer or accelerated filer status) would be required to own 5 percent of the company’s securities.

¹³ Shareholders whose purpose is to put forward a proposal that would result in any material change in the issuer’s business or corporate structure are required to file a Schedule 13D.

Act and prior Commission proposals on proxy access.¹⁴ It will be easier to administer and provide companies and shareholder proponents with more certainty.

Ownership Thresholds. Proxy access must be granted only to shareholders with a substantial ownership interest, so that their interests can reasonably be expected to align with those of other long-term shareholders. Unlike a fund's directors, these shareholders have no fiduciary obligation to act in the interests of other shareholders, and the federal securities laws do not provide other mechanisms to assure that they do so. The ownership thresholds must be sufficiently high to limit the circumstances under which a single investor is able to nominate a director, in order to decrease the likelihood of a nomination that might be designed to achieve objectives that could be inconsistent with the company's structure and objectives, and unrelated to effective board governance.¹⁵

The Commission's proposed thresholds are not sufficiently high for these purposes. As the Commission points out, for each category of company the Commission studied (large accelerated filers, accelerated filers, and non-accelerated filers), a substantial number of companies in each category has at least one shareholder who meets the applicable ownership threshold and two or more shareholders that easily could aggregate their securities in order to meet the applicable ownership threshold.¹⁶ A very significant number of Institute members often have holdings of one, three, and five percent or more of the issuers in which they are invested.¹⁷

¹⁴ See SEC Release No. 34-56160 (July 27, 2007), 72 FR 43466 (August 3, 2007) (proposed Rule 14a-8(i)(8)(ii)(B)); and SEC Release No. 34-48626 (October 14, 2003), 68 FR 60784 (October, 23, 2003) (proposed Rule 14a-11(b)(3)).

¹⁵ A recent ICI study of proxy voting by investment companies found that sponsorship of shareholder proposals is fairly concentrated. For example, half of the 239 shareholder proposals offered at companies with shareholder meetings from July 1, 2006 to June 30, 2007 were sponsored by just five individuals. And while 19 labor unions submitted 186 shareholder proposals during the same period, three unions submitted half of these. As the study notes, "although diverse groups and individuals offer shareholder proposals, the majority of proposals are offered by a limited number of individuals and institutions whose interests do not necessarily represent those of all of a company's shareholders." Investment Company Institute, *Proxy Voting by Registered Investment Companies: Promoting the Interests of Fund Shareholders*, Research Perspective, Vol. 14, No. 1 (July 2008), at pp. 1 and 6-7.

¹⁶ See Release at pp. 46-48.

¹⁷ Based on data from © CRSP University of Chicago and the Institute, we were able to examine portfolio holdings of 146 mutual fund complexes as of the fourth quarter of 2008. Based on this analysis, we estimate that 146 mutual fund complexes had a total of 11,055 holdings of 1 percent or more; 89 mutual fund complexes had a total of 3,395 holdings of 3 percent or more, and 61 mutual fund complexes had a total of 1,437 holdings of 5 percent or more of the U.S. companies in which they invest. In far fewer instances do they hold 10 percent or more of a portfolio company. At a 10 percent threshold, we estimate that 23 mutual fund complexes had a total of 269 holdings that met or exceeded the threshold. These figures demonstrate the effect of increasing the thresholds on the need for shareholders to work in a collaborative manner to obtain access to a company's proxy – a laudable goal that will protect the interests of long-term shareholders. (Of course, individual funds would need to determine that seeking access to a company's proxy to nominate a director is in the fund's best interests.)

Given the major change in approach that the proposal represents from current requirements and the ease with which at least some investors will be able to reach the proposed thresholds, we strongly recommend that the Commission proceed cautiously by starting with a higher minimum threshold. A higher threshold would encourage shareholders to come together to effect change, better assuring that the company's proxy machinery would be used to advance the common interests of many shareholders in addressing legitimate concerns about the management and operation of the company. Accordingly, we recommend that shareholders who own at least ten percent of a company's securities for the required holding period be permitted to nominate directors on a company's proxy statement.¹⁸

The Release requests comment on whether eligibility should be conditioned on meeting the required ownership threshold by holding a net long position for the required time period. We believe it should and therefore we strongly recommend that the Commission make clear in any adopting release that shareholder proponents who borrow stock of an issuer may not count those shares toward meeting the ownership threshold or the holding period (discussed below) adopted by the Commission. Rather, beneficial ownership would be required to assure that the proponents truly are significant and long-term shareholders.

Holding Period. From what we can tell, the Commission did not analyze holding periods with respect to any issuers.¹⁹ We recommend that before adopting any final holding periods, the Commission first analyze relevant data. This analysis should help the Commission determine how best to achieve the policy goal of establishing a meaningful holding period that will further assure that the interests of shareholder proponents are aligned with the interests of long-term shareholders.²⁰ We believe that a longer holding period than that proposed, such as two years, would provide greater assurance that shareholder proponents are committed to the long-term mission of the company, rather

¹⁸ We recommend a higher ownership threshold for Rule 14a-11 than for Rule 14a-8 because the more unfettered access provided by 14a-11 should be coupled with a higher floor. In addition, we believe a single threshold is preferable to tiered thresholds because it will be easier to administer, particularly given the prospect of fluctuations in market value and company mergers.

¹⁹ The Release details the varying views of commenters on the Commission's 2003 proposal with respect to the appropriate holding period, and summarily concludes that the Commission believes "that a one-year holding requirement would be sufficient to appropriately limit use of Rule 14a-11 to long-term shareholders without placing an undue burden on shareholders seeking to use the rule." See Release at p. 51.

²⁰ Based on the Institute's analysis, we estimate that 38 mutual fund complexes had 620 holdings that were 5 percent or more in both the fourth quarter of 2007 and the fourth quarter of 2008 (*i.e.*, a one-year holding period). At a 10 percent threshold and a one-year holding period requirement, we estimate that 13 mutual fund complexes had 63 holdings of U.S. companies. For a two-year period (2006-2008) and 5 percent threshold, we estimate that 28 mutual fund complexes had 370 holdings. For a two-year holding period and 10 percent threshold, we estimate that 8 mutual fund complexes had 28 holdings.

than seeking an opportunity for personal gain and quick profits at the company's and other shareholders' expense.²¹

B. Maximum Number of Shareholder Nominees

The Commission has proposed requiring companies to include no more than one shareholder nominee or the number of nominees that represents 25 percent of the company's entire board, whichever is greater. The Release asks if it is appropriate to include a limitation on the number of shareholder director nominees and whether the proposed maximum percentage of shareholder nominees is appropriate. We strongly recommend permitting no more than one shareholder nominee. Permitting shareholders to have their director nominees included in a company's proxy materials is unprecedented. Given its novelty, it is appropriate to limit the number of nominees to one. This approach will lessen the chances that a well-functioning, dedicated board will be disrupted by shareholder nominated directors pursuing narrow interests not shared by other shareholders.

The Release also requests comment on whether, in the case of a staggered board, the maximum number of shareholder nominees should be based on the number of directors to be elected rather than the overall board size. We recommend basing the maximum number of shareholder nominees on the number of directors to be elected, which would address our concerns regarding the potential for multiple shareholder nominees disrupting the board's smooth functioning.

We also recommend counting shareholder nominated directors as such for at least three years against the rule's limitations. It typically takes some time for a director to become knowledgeable about a business and fully contribute to the work of the board. It would assist the smooth functioning of the board if one shareholder nominee was given adequate time to become acclimated before another shareholder nominee could join the board.

C. Timing of Submitting Nominees

The Commission has proposed requiring any company to include in its proxy statement and form of proxy the nominee(s) of the first shareholder proponent from which it receives timely notice of intent to nominate a director, up to and including the total number of shareholder nominees required to be included by the company. The Release requests comment on whether this "first in" approach is appropriate. We believe that it would be fairer to permit the shareholder or group of shareholders with the most significant stake in the company to put forward its nominee. Such a standard would

²¹ We note that most investment companies are long-term holders of the securities in which they invest. Based on the Institute's analysis, we estimate that 162 fund complexes held shares of 3,037 U.S. companies for at least two years over the period from the fourth quarter of 2006 to the last quarter of 2008. Others that have examined the issue of proxy access have concluded that a two-year holding period would be appropriate. *See, e.g.*, The Council of Institutional Investors Corporate Governance Policies, Section 3.2, which can be accessed at http://www.cii.org/UserFiles/file/council_percent20policies/CII_percent20Full_percent20Corp_percent20Gov_percent20Policies_percent205-7-09.pdf.

encourage shareholders to work together to effect change. In addition, it would not be difficult for a company to administer, provided that nominees are required to be submitted sufficiently in advance of the meeting, and shareholder proponents are required to provide companies with a written statement from their record holder verifying the number of shares beneficially owned.²²

D. Notice and Disclosure Requirements for Shareholder Proponents

To submit a nominee for inclusion in a company's proxy statement and form of proxy, a nominating shareholder or group would have to (i) provide a notice on Schedule 14N to the company of its intent to require the company to include that shareholder's or group's nominee(s) in the company's proxy materials and (ii) file the notice with the Commission on the date it is provided to the company.

The Release requests comment on whether the proposed content requirements of the shareholder notice on Schedule 14N are appropriate. While we generally support the proposed notice and disclosure requirements, we recommend adding a requirement that nominating shareholders disclose their motivation in seeking a nomination (*e.g.*, to gain publicity for a particular policy issue)²³ and any formerly recommended nominees (including how many such nominees and their identities). We believe this is pertinent information that the Commission and the company should be provided to assist them in evaluating the intent of the shareholder proponent.

In addition, we particularly support the proposed requirement that Schedule 14N include a written statement from the record holder of the shares beneficially owned by the nominating shareholder verifying that, as of the date of the shareholder notice on Schedule 14N, the shareholder continuously held the minimum required of securities for the requisite time period.²⁴ Such a requirement is essential given that shares are typically held by brokers and banks in omnibus accounts. The prevalence of omnibus accounts, along with Commission rules²⁵ prohibiting banks and broker-dealers from providing issuers with the names of certain shareholders, often makes it difficult, if not impossible, for issuers to verify the extent and length of their beneficial shareholders' ownership of company shares.

The Release also requests comment on whether the nominating shareholder or group and/or nominee should be required to disclose any meetings or contacts, including direct or indirect

²² See Item 5 of Schedule 14N.

²³ This requirement also should apply to shareholder nominees.

²⁴ See Item 5(a) of proposed Schedule 14N.

²⁵ See Rules 14b-1 and 14b-2 under the Exchange Act.

communication by the shareholder, with the management or directors of the company that occurred during the 12-month period prior to formation of any plans or proposals with respect to the nomination. We believe it is unnecessary and burdensome to require disclosure about all meetings or contacts with management that occurred during this period. Institutional investors frequently engage in discussions with management as part of their investment management process; it will be burdensome for these shareholders to keep records of all meetings or contacts with each company they communicate with simply because they may, sometime in the future, nominate a director. To avoid this recordkeeping burden, shareholders may choose to have fewer of these informal discussions, which seems at odds with the Commission's intent to facilitate shareholder communication with management. In addition, requiring such broad disclosure will capture irrelevant information, such as management-shareholder investment meetings that have no relation to a future nomination. Therefore, we would oppose requiring this type of disclosure.

E. Requirements for Company that Receives a Notice from Nominating Shareholders

Universal Proxy. Proposed Rule 14a-4(b)(2)(iv) would require a company to include both company nominated and shareholder nominated directors on a single form of proxy. In the case of proxies with shareholder nominees, there will be more nominees listed than there are open directorships. The company would be allowed to indicate for each nominee whether the board recommends a vote "for" the nominee, but the company no longer would be permitted to provide shareholders with the ability to check a box and vote for the entire company-recommended slate. The Release requests comment on whether companies should provide shareholders the option of voting for the company's slate of nominees as a whole.

It is unclear, as a practical matter, how a firm tabulating a shareholder vote would treat any form of proxy that was voted for more directors than there are board positions. Neither existing Commission rules nor the proposal address this critical issue. Simplicity with respect to voting mechanics is necessary so as not to unintentionally disenfranchise shareholders. We therefore strongly recommend permitting issuers to provide shareholders with the ability to check a box and vote for the entire company-recommended slate.

Liability. The Commission has taken several steps in the proposal to make clear that the nominating shareholder, not the company, will have liability for any materially false or misleading statements in information provided by the shareholder that is then included in the company's proxy materials.²⁶ The Release requests comment on whether the proposal makes clear the company's responsibilities when it includes such information in the proxy. We strongly support the Commission expressly providing in rule text that the nominating shareholder would be liable for statements *provided by* the nominating shareholder to the company and included in the company's proxy materials.

²⁶ See proposed Rules 14a-9(c), 14a-11(e), and 14a-19.

Consistent with this approach, the Institute recommends modifying the proposal to provide that a company would not be responsible for any disclosure in the company's proxy statement *based on* information provided by the nominating shareholder.

As proposed, a company would be responsible if it includes in its proxy materials information provided by the nominating shareholder that it "has reason to know" is false and misleading. We believe that such a requirement would place an unfair burden on companies to perform some undefined amount of due diligence regarding the information provided by nominating shareholders. For example, it is unclear whether a company would have to perform its own due diligence to verify that the nominating shareholder has provided it with complete information regarding any criminal proceedings the nominee has been involved in over the last ten years.²⁷ Therefore, we recommend modifying the proposal so that the company only would be responsible for false and misleading information provided by a nominating shareholder if the company knows that information is false or misleading.

Our concerns with respect to potential liability apply equally in the context of shareholder proposals for bylaw amendments, and we therefore support the comparable provisions proposed by the Commission, subject to the modifications we recommend above.

F. Other Comments

Beneficial Ownership Requirements. Under the proposal, a nominating shareholder whose activities are limited to nominating a candidate, soliciting on behalf of that candidate, or having that candidate elected would be permitted to report its share ownership on Schedule 13G, rather than Schedule 13D. The Institute believes that a shareholder that engages in the activities described above should not be viewed as having the purpose or effect of changing or influencing control of a company and should be permitted to file a Schedule 13G. Therefore, we support the proposed approach.

Section 16 under the Exchange Act. Under the proposal, Rule 16a-1(a)(1), which defines who is a 10 percent owner for Exchange Act Section 16 purposes, would not be amended to exclude from that definition a Rule 14a-11 nominating shareholder group. As a result, whether that group would be subject to Section 16's provisions regarding reporting or short swing profits would be determined by applying the existing analysis of whether a group is formed. The Institute believes that a group formed solely for the purpose of (i) nominating a director under proposed Rule 14a-11, (ii) soliciting in connection with the election of that nominee, or (iii) having that nominee elected as director should not be viewed as the type of group that should be aggregated together for purposes of Section 16. The group's actions are fully disclosed, not for a "control" purpose, and they do not have presumed "insider" status. The Release points out that because the proposed thresholds are significantly lower than 10 percent, the Commission does not believe that the lack of an exclusion from Section 16 would have a

²⁷ See Rule 14a-18(g) (requiring disclosure about the nominee in response to the disclosure requirements of Item 5(b) of Schedule 14A).

deterrent effect on the formation of groups. However, as pointed out previously, investment company holdings, particularly if coupled with the holdings of other investment companies, could easily reach Section 16's 10 percent threshold.²⁸ Accordingly, we urge the Commission to revise the proposed approach.

III. Applicability to Investment Companies

The proposal would apply to all companies subject to the Commission's proxy rules, including registered investment companies and business development companies.²⁹ The Release asks if the proposal should apply to registered investment companies and whether there are any aspects of the nomination procedures that should be modified in the case of registered investment companies. We recommend that the current proposal exclude investment companies, for the following reasons.

First, the Release does not articulate the Commission's policy rationale for applying the proposed requirements to investment companies. Seeking comment on whether investment companies should be covered is not an adequate substitute for performing the analysis and making the well-informed policy judgments that should underlie the proposed application to investment companies of any Commission rulemaking initiative, particularly such a significant one.³⁰ Second, while we recognize that the Commission tailored the proposal for investment companies in a number of technical respects to reflect the differences in applicable regulatory schemes,³¹ the proposal does not remotely account for the significant differences in governance models between public operating companies and investment companies, including the most prevalent types of investment company boards—unitary or cluster boards—and other important differences. Finally, the Commission has not given sufficient consideration to the potential impact of the proposed requirements on investment companies, particularly on small fund complexes.

²⁸ Such a revision also would be necessary if the Commission adopts our recommended threshold.

²⁹ BDCs are not technically registered as investment companies but are subject to many of the same requirements as registered investment companies.

³⁰ See Release at p. 75 (“Amending our rules to provide for the inclusion of shareholder nominees for directors in a company's proxy statement is a significant change.”)

³¹ See, e.g., Rule 14a-18(c) (requiring that shareholders represent that their nominee is not an “interested person” of the registered investment company as defined in Section 2(a)(19) of the Investment Company Act and requiring in the case of other registrants, that shareholders represent that their nominee meets the objective criteria for independence of the relevant national securities exchange); and Rule 14a-11, Instruction 1 to paragraph (b) (for purposes of determining the securities that are entitled to be voted on the election of directors, permitting shareholder proponents of companies other than registered investment companies to rely on the company's most recent quarterly or annual report and permitting shareholder proponents of registered investment companies to rely on the investment company's most recent annual or semi-annual report filed on Form N-CSR).

The Commission first should establish that there is a need for proxy access requirements regarding director nominations or related bylaw provisions in the investment company context. Only if it so determines, it should then develop a tailored proposal that is designed specifically for investment companies and weigh its anticipated benefits against any resulting costs and burdens for investment companies generally and small funds in particular.³² These steps are the basic building blocks of a sound rulemaking process, and the Commission is bound by statute to follow them.³³

These comments are discussed in greater detail below.

No Empirical Analysis of Need for Proxy Access in Investment Company Context. The Release presents no empirical data or other information to explain the Commission's policy basis for extending the proposed requirements to investment companies. Given the unique features of investment companies discussed further below, as well as the size of the investment company universe, it is inappropriate for the Commission reflexively to "lump in" investment companies with operating companies under the proposal. Such rulemaking by default also has the potential to expose the Commission to legal challenge. The Commission and public policy will be far better served if the Commission engages in the focused and thorough analysis necessary to determine whether proxy access requirements are needed in this context and, if so, what form they should take.

We recognize that the Commission took steps toward determining the contours of proxy access using empirical analysis. In particular, the Commission used empirical data to analyze the holdings information of some issuers to determine the proposed eligibility thresholds. At the same time, it is telling that this analysis did not cover mutual funds or other types of investment companies.³⁴

³² The United States Court of Appeals for the District of Columbia Circuit has emphasized the importance of the Commission adequately considering the costs regulated entities would incur in order to comply with a rule. *See Chamber of Commerce v. Securities and Exchange Commission*, 412 F.3d 133, 144 (June 21, 2005) ("uncertainty ... does not excuse the Commission from its statutory obligation to do what it can to apprise itself – and hence the public and the Congress – of the economic consequences of a proposed regulation before it decides whether to adopt the measure."); *American Equity Investment Life Insurance Company v. Securities and Exchange Commission*, Case No. 09-1021 (July 21, 2009) (finding that the SEC's analysis of effects on efficiency, competition, and capital formation in adoption of rules related to indexed annuities was arbitrary and capricious, and remanding the matter to the Commission for reconsideration).

³³ As the Release indicates at pp. 199-200, the Commission is required to consider the impact that the proposal would have on competition, and is prohibited from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act. *See* Section 23(a)(2) of the Securities Exchange Act. The Commission also must consider, "in addition to the protection of investors, whether [the rule proposal] will promote efficiency, competition, and capital formation." *See* Section 3(f) of the Securities Exchange Act and Section 2(c) of the Investment Company Act.

³⁴ *See* Release at note 129 ("The sample excludes mutual funds.") While BDCs, depending on their size, can be accelerated filers, large accelerated filers, or non-accelerated filers, the Release does not indicate whether the Commission analyzed holdings of BDCs as part of its analysis. The Release also does not indicate if the holdings of exchange-traded funds or closed-end funds were analyzed.

Similarly, it is not apparent that the staff's review of the frequency of shareholder proposals under Rule 14a-8 and proxy contests encompassed investment companies.³⁵

Unitary or Cluster Boards. Most funds today are part of complexes comprising multiple funds managed by the same investment adviser. Boards of these funds generally are organized according to one of two models – a “unitary” board consisting of one group of directors who serve on the board of every fund in the complex, or “cluster” boards consisting of two or more separate boards of directors within the complex, that each oversees a different group of funds. Clusters typically are organized according to investment objective, investment sector or distribution channel or result from a merger of complexes that were initially organized under separate management.

A variation on the unitary board model is used by many smaller fund advisers. Several third party service providers provide smaller advisers with the option of their fund joining a shared trust and paying a fee in exchange for receiving fund start-up and organization services, fund administration, fund distribution, fund accounting and pricing, transfer agent and shareholder services. These services, and their associated costs, are shared by all the funds that are members of the same trust. Outsourcing these services to a third party allows these advisers to focus on their area of expertise—managing fund assets—and provide their shareholders with significant savings. A shared trust has one board that oversees all of the funds managed by this group of otherwise unrelated advisers.³⁶

A recent joint Institute and Independent Directors Council survey showed that of the complexes responding to the survey, 81 percent had a unitary board structure and 15 percent had a cluster structure.³⁷ These results are not surprising given the many benefits associated with unitary and cluster board structures.³⁸ For example, service on multiple boards can provide the independent directors of those boards with an opportunity to obtain better familiarity with the many aspects of fund operations that are complex-wide in nature.³⁹ It also can give the independent directors greater access

³⁵ The Commission specifically referenced investment companies in its discussion of the proposal for purposes of the Paperwork Reduction Act and the Regulatory Flexibility Analysis.

³⁶ See, e.g., <http://www.seic.com> for a more detailed discussion of these services.

³⁷ See Investment Company Institute and Independent Directors Council, *Overview of Fund Governance Practices, 1994-2006* (2007). While the report's findings are not broken down among mutual funds, closed-end investment companies, ETFs, and BDCs, Institute members have informed us that it is common practice for all of these types of funds to employ unitary or cluster board structures.

³⁸ See, e.g., Sophie Xiaofei Kong and Dragon Yongjun Tang, *Unitary Boards and Mutual Fund Governance* (November 27, 1997) (finding strong evidence for unitary boards as an effective governance mechanism) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1033057. Cf. *T. Robert Verkouteren vs. Blackrock Financial Management*, 37 F. Supp. 2d 256 (February 4, 1999) (where the court recognized the prevalence of common boards within mutual fund complexes).

³⁹ These aspects include, for example, the nature and quality of compliance, administrative, transfer agency and custodial services, as well as the distribution channels used by the complex.

to the fund's adviser and greater influence over the adviser than they would have if there were a separate board for each fund in the complex. Moreover, it would be much more difficult to attract highly qualified directors if they were limited to service on the board of only one fund in a complex. There also would be additional costs, administrative complexities and redundancies. Some fund complexes would be required to have scores of independent directors. For these reasons, the Institute's Advisory Group on Best Practices for Fund Directors recommended that all fund complexes with any substantial number of funds generally adopt either a unitary or cluster board structure.⁴⁰

In its current proposal, the Commission recognized that funds may be organized in series form and proposed that the net asset thresholds apply to the company as a whole, and not on a series by series basis, because directors are elected for the company as a whole.⁴¹ Proposed Rule 14a-11 provides that "[i]n connection with an annual meeting of shareholders ... at which directors are elected, a *registrant* ... will be required to include in its proxy statement and form of proxy the name of a person or persons nominated by a shareholder or group of shareholders for election to the board of directors...." (Emphasis added.)

Reading these provisions together leads to disparate results for fund complexes with unitary boards, depending on whether the complex consists of a single registrant (with multiple series) or multiple registrants.

If the complex consists of a single registrant, the net asset thresholds would apply to the complex as a whole. A shareholder in any of those series could nominate a director who then would be voted on by shareholders of all the series. If elected, that director then would be on the board overseeing all of the funds in the series/complex.

If the complex consists of multiple registrants with a unitary board, and a shareholder in one of the registered funds nominates a director, who is elected, the complex will no longer be able to have a unitary board. They will have one board overseeing all the funds in the complex except the one with the new director, which will cause the fund to incur additional costs and experience administrative difficulties. For example, arrangements would have to be made for that director to leave during any discussions that only pertain to other funds in the trust. Further, board materials would have to be customized for that director. Rule 17a-7, for example, requires an investment company board, including a majority of independent directors, to determine no less frequently than quarterly that certain fund purchases and sales of portfolio securities made during the preceding quarter were effected in compliance with the fund's procedures. Unitary and cluster boards typically are provided with

⁴⁰ See *Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness* (June 24, 1999).

⁴¹ See Release at note 134 and Investment Company Act Rule 18f-2(g).

aggregate data for all of the funds they oversee, which they then use to conduct their review.⁴² They also apply one set of procedures to all of the funds subject to their oversight. This efficient process would be disrupted if the data had to be disaggregated to some extent and procedures tailored for a particular fund.

These concerns are especially acute because in order to fulfill their oversight responsibilities, fund directors routinely receive highly confidential information about funds they oversee. Such information might include, for example, information related to fair valuation of fund portfolio securities or to significant compliance matters. It is essential to maintain the confidentiality of fund information and seeking to do so will substantially complicate board processes if a given director does not serve on the board of a particular fund. Similarly, fund complexes and boards likely would face additional challenges in connection with seeking to preserve the status of privileged information in these circumstances.

Setting up procedures to deal with these issues will generate additional costs that ultimately will be borne by shareholders. (This result would be the same for a complex consisting of multiple registrants with cluster boards.) These burdens will be exacerbated in the case of small fund advisers as explained below.

Alternatively, a fund complex with a unitary board could designate a shareholder nominee for the board of one fund as a management nominee in the proxy materials for the other funds in the complex. As a result, the nominee, if elected, could serve as a director for all of the funds overseen by the unitary board. While this would resolve the difficulties described above, it effectively would permit the proponent to do an end run around the Commission's thresholds with respect to all the funds in the complex except one. That is, the proponent could purchase enough shares in the complex's smallest fund to meet the threshold requirements and then be placed on the ballots for, and potentially the boards of, all the funds in the complex.

We do not believe that the Commission intended funds to be faced with such a Hobson's choice. Pending further study of whether, and if so, how, proxy access rules should apply in the investment company context, the Commission should exclude investment companies.

Investment Companies Differ from Operating Companies. The Commission and its staff previously have recognized the distinctions between investment companies and operating companies. Most recently, the Commission approved an amendment to NYSE Rule 452 that will prohibit broker discretionary voting for the election of directors for all issuers *except* registered investment companies. The decision to exempt registered investment companies was based on the premise that "the unique regulatory scheme governing registered investment companies differentiated them from operating

⁴² These boards also review aggregate data and apply uniform procedures in connection with their quarterly reviews under Investment Company Act Rules 17e-1 and 10f-3.

companies” and that “they are subject to the Investment Company Act, which, among other things, also regulates shareholder participation in key decisions.”⁴³

As the Commission recognized in the Broker Voting Release, the Investment Company Act supplements state law in a number of key respects by regulating shareholder participation in key decisions, unlike shareholders of operating companies. Registered investment company shareholders are prohibited from engaging in a variety of transactions and activities unless they first obtain shareholder approval. These transactions and activities include: changing from an open-end, closed-end, or diversified company; borrowing money, issuing senior securities, underwriting securities issued by other persons, purchasing or selling real estate or commodities or making loans to other persons, except in accordance with the policy in the registration statement; or deviating from a stated policy with respect to concentration of investments in an industry or industries, from any investment policy which is only changeable by shareholder vote, from any stated fundamental policy, or changing the nature of its business so as to cease to be an investment company.⁴⁴ In addition, a registered investment company’s contract with its investment adviser and distributor (and any material amendments to those contracts) must be approved by a majority of its outstanding voting securities;⁴⁵ and any shareholder of a registered investment company may bring an action against the company’s investment adviser for breach of fiduciary duty with respect to receipt of compensation for services or payments of a material nature paid by such company.⁴⁶

⁴³ See Securities Exchange Act Release No. 60215 (July 1, 2009) (“Broker Voting Release”). The Broker Voting Release also stated as a consideration the heightened problems that registered investment companies have in achieving quorums because of their disproportionately large retail shareholder base. The Commission did not exempt BDCs from Rule 452’s prohibition on discretionary broker voting for the election of directors because the Investment Company Act “requires a BDC to seek ratification of the independent auditor, which is a routine item under NYSE Rule 452, at each annual meeting. Adoption of the amendment will therefore have no effect on a BDC’s ability to obtain a quorum....” See Broker Voting Release at p. 40.

⁴⁴ See Section 13(a) of the Investment Company Act. Section 13 works in tandem with Section 8(b) of the Investment Company Act, which requires registered investment companies to recite these policies in their registration statements. BDCs are not subject to Section 13 because the Investment Company Act prescribes the limits of the fundamental investment policy of a BDC. See S. Rep. No. 958, 96th Cong., 2d Sess at 33 (1980) and H.R. Rep. No. 1341, 96th Cong., 2d Sess. at 51-52.

⁴⁵ See Section 15(a) and (c) of the Investment Company Act with respect to advisory contracts and Rule 12b-1 with respect to distribution agreements. BDCs are subject to these same requirements with respect to advisory agreements but not with respect to distribution agreements.

⁴⁶ See Section 36(b) of the Investment Company Act. See also Brief for the United States as Amicus Curiae Supporting Petitioners Jerry N. Jones, et al. v. Harris Associates L.P. at p.4 citing *Daily Income Fund Inc. v. Fox*, 464 U.S. at 535, 536, 541 (1984) (“[I]n amending the ICA in 1970, Congress added Section 36(b) ... which created a ‘new’ and ‘unique right’ by giving security holders and the SEC an ‘independent check[] on excessive fees.’”) BDCs are subject to Section 36(b).

Despite these longstanding and widely recognized differences between operating companies and investment companies, the Commission's proposal does not draw any distinction in the application of the fundamental requirements of the proposal. Further, it appears from the Release that the Commission was trying to influence operating company, rather than investment company, board functions in designing the rule proposal. For example, the Commission states that one of the possible costs of the proposal is that the time that a board spends on shareholder relations could reduce the time that it would otherwise spend on strategic and long-term thinking and overseeing management, which may negatively affect shareholder value.⁴⁷ The Commission also states that faced with the prospect of a shareholder-nominated director being elected, directors may work more diligently to improve the performance of the company. The board functions described are those of an operating company, not an investment company, board.

While it is the responsibility of an investment company board to oversee the adviser's performance, that role is within a different context than that of an operating company board taking steps to improve the performance of the company. As a practical matter, the fund board must take into account that fund shareholders have chosen the adviser in the context of the disclosures in the fund's prospectus and other documents that set forth the material facts concerning the adviser, the fund's investment objectives, strategy and risks, and the management fee structure and other expenses of investing in the fund.⁴⁸ Against this backdrop, fund directors can avail themselves of a number of steps to improve the fund's performance, including increasing the adviser's research capabilities, moving to a team approach of portfolio management, or retaining a sub-adviser.

We strongly believe that, given these differences and the mismatch between the Commission's goals and the functions of investment company boards, investment companies should be excluded from any final rule. The corporate governance system that Congress and the Commission have thoughtfully crafted for investment companies has worked well for funds and their shareholders for close to seventy years⁴⁹ and should not be altered without first comprehensively considering the significant

⁴⁷ See Release at p. 190 (citing Lynn A. Stout, *The Mythical Benefit of Shareholder Control*, 93 Va. L. Rev. 789, 792 (2007) ("Perhaps the most obvious [economic function of board governance] is promoting more efficient and informed business decision making.")).

⁴⁸ As one of the Investment Company Act's draftsmen noted, "[T]he board 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." See Jaretzki, Jr. Alfred, *Duties and Responsibilities of Directors of Mutual Funds*, 29 Law and Contemporary Problems, 777, 786 (1964).

⁴⁹ The Commission staff stated its agreement with this view following a comprehensive reexamination of the regulation of investment companies. See *Protecting Investors: Report of the Division of Investment Management* (1992) at p. 253 (where the staff stated, "[t]he Division has reexamined the adequacy of the governance structure for investment companies. Our purpose was to analyze whether changes could be made to the existing structure that would increase the effectiveness of boards of directors in monitoring conflicts of interest, [and] provide shareholders with more meaningful voting opportunities.... The Division has concluded that the governance model embodied in the Act is sound and should be

ramifications for funds and their shareholders and only after such critical steps are taken, determining whether devising proxy access requirements related to fund director nominations or the nominating process is appropriate.

Impact on Small Fund Advisers. Small fund advisers represent an important segment of the investment company industry. In addition to providing choices for investors and encouraging competition, they have historically been prolific sources of innovation and purveyors of highly specialized investment products. For example, small fund complexes popularized socially responsible funds, and some specialized products, such as municipal bond funds for particular states, are still only available from small fund advisers. Small fund advisers are likely to bear a significant burden from the imposition of proxy access on investment companies if, as a result, they are forced to pay service providers additional fees for responding to their unique board situations or alternatively, staffing and paying their own boards, rather than using a bundled package of services.

Expense ratios typically already are higher than average for small funds.⁵⁰ To avoid increasing expense ratios, small fund advisers may 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.⁵¹ These practices suggest that, for funds to attract and retain shareholders, there is essentially a market-imposed constraint on their expense ratios.

If small fund advisers were no longer able to utilize a cluster or unitary board arrangement (including sharing a trust and common board with other unrelated funds), they may be compelled to absorb these additional costs, squeezing their profit margins further. Figures on fund advisers' profitability are unavailable, but anecdotal evidence suggests that small fund advisers operate under thin margins. The expected smaller rate of return on capital may dissuade some entrepreneurs from entering the investment company industry, and force the exit of some fund advisers with thin profit margins.

It does not appear that the Commission considered this effect of the proposal as part of its mandates to consider (i) the impact of the proposal on competition and (ii) whether the proposal will promote efficiency, competition, and capital formation.

retained with limited modifications.") Neither the recommended modifications nor subsequent changes to strengthen investment company governance included proxy access requirements related to fund director nominations or the nominating process. *See, e.g.*, SEC Release No. IC-26520 (July 27, 2004), 69 FR 46378 (Aug. 2, 2004).

⁵⁰ *See, e.g.*, Letter from Members of Small Funds Committee, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated August 21, 2006 (regarding the Commission's proposed independent chair requirement for investment companies) at Appendix B.

⁵¹ *Id.* at Appendix C.

IV. Other Comments

For the reasons discussed above, the Institute believes it is inappropriate to apply the current proposal to investment companies as issuers. Should the Commission, in the future, develop a new proposal for investment companies after conducting the analysis necessary to properly formulate such a proposal, we urge the Commission to consider the following comments in addition to those discussed in Sections I and II above.

A. Intent of Ownership

As indicated above, we strongly support limiting access to a company's proxy statement to shareholders who do not hold or have not acquired shares "for the purpose of or with the effect of changing or influencing control of the company or to gain more than a limited number of seats on the board." We note that this approach is particularly important in the investment company context to make clear that access would be denied to shareholder proponents who intend to "open-end" a closed-end fund.⁵² This is an appropriate result, necessary to protect the interests of closed-end fund shareholders whose investment goals are achieved through the unique features of a closed-end fund.⁵³

B. Independence of Shareholder Nominees

The Commission has proposed requiring a shareholder proponent to represent that any nominee to the board of an operating company is "independent" under self-regulatory standards. In the case of an investment company, the required representation would be that the nominee is not an "interested person" of the investment company, as defined in Section 2(a)(19) of the Investment

⁵² Shareholders whose purpose is to put forward a proposal that would result in any material change in the issuer's business or corporate structure are required to file a Schedule 13D. If the issuer is a registered closed-end investment company, this requirement extends to any proposals to change an investment policy for which a vote is required under Section 13 of the Investment Company Act. See Item 4(f) of Schedule 13D (requiring such intent to be disclosed on Schedule 13D). Investment Company Act Section 13, in turn, requires a shareholder vote to authorize an investment company to change its classification from a closed-end to an open-end fund.

⁵³ Closed-end fund shares are bought and sold on the open market and, consequently, can trade at a discount or a premium to the fund's net asset value. In recent years, the shares of many closed-end funds frequently have traded at a discount. While eliminating a discount has an obvious short-term benefit – the potential for immediate realization of the difference between a fund's market price and its net asset value – some of the methods of eliminating the discount (*e.g.*, converting to an open-end fund) fundamentally change the nature of a fund's original purpose, cause the distribution of capital gains, and increase fund expenses, all of which may be at odds with the interests of long-term shareholders. Closed-end funds have greater flexibility to invest in less liquid securities because they do not need liquidity to meet redemptions like open-end funds. Consequently, many closed-end funds invest in specialized markets that may not be viable investment options for open-end funds. Examples include "single country" funds that invest in foreign securities issued by companies in a particular country, "senior loan" funds that invest in senior secured corporate loans with floating interest rates, and "small-cap" funds that invest in small capitalization and thinly traded securities. If such a fund were forced to open end, it would have to materially modify its investment policies, even though many of the fund's investors likely have chosen it *precisely because* of these investment policies.

Company Act. The Release requests comment on whether the Commission should apply the “interested person” standard of Section 2(a)(19) with respect to the representation that a nominee be independent from an investment company. The Institute strongly agrees that because, as noted in the Release, the Section 2(a)(19) test is tailored to the types of conflicts of interest faced by investment company directors, it is more appropriate for investment company directors than the independence standard applied to directors of other companies. In addition, such a provision is critical given that investment companies must have a specified percentage of independent directors to be able to comply with certain statutory and regulatory requirements.

It often is not immediately apparent when a nominee’s relationships and investments make the nominee ineligible under Section 2(a)(19). This is particularly true for investment companies that have subadvisers or whose adviser is part of a large a financial services firm. To identify such relationships, most investment companies ask all nominees and potential nominees to complete a detailed questionnaire. We recommend that the Commission clarify that shareholder nominees would be required to satisfactorily complete the same questionnaire as other nominees at the company’s request.

C. Universal Proxy

As explained in Section II above, we strongly recommend permitting operating companies to provide shareholders with the ability to check a box and vote for the entire company-recommended slate. 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, it is more difficult for investment companies to achieve quorums. Investment companies that fail to achieve quorum are forced to adjourn meetings and/or engage in multiple solicitations, thereby significantly increasing costs for investment company shareholders.⁵⁴ Making the recommended change therefore is essential in any rules that will apply to investment companies.

D. Disclosure Requirements

The Commission has proposed requiring disclosure regarding nominating shareholders and nominees, which we generally support. In addition, we recommend that any investment company nominating shareholder and nominee be required to disclose their motivation, including, among other

⁵⁴ In deciding to approve an amendment to NYSE Rule 452 prohibiting broker voting for all issuers *except* investment companies, the Commission cited as a consideration the heightened problems that registered investment companies have in achieving quorums because of their disproportionately large retail shareholder base. Institute data shows that 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. This data was consistent with data as of year-end 2005 that formed the basis for the Institute’s report finding that engaging in multiple solicitations causes typical proxy costs to more than double from \$1.65 to \$3.68 for each shareholder account and expense ratios to rise between one to two basis points, on average, with some investment companies’ expense ratios increasing more than five basis points. *See Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors* (December 18, 2006).

matters, whether there is any intention to modify the fund's investment objective or policies. This disclosure would be important to assist shareholders in making an informed voting decision, since presumably they have bought fund shares based on the fund's current investment objective as stated in the fund's prospectus. Further, we recommend requiring nominees to disclose if they are members of, or intend to seek membership on, boards of other unaffiliated investment companies. If a board member also sat on the board of another investment company, antitrust concerns could be raised and the free discussion among board members might be seriously compromised. Shareholders should be able to evaluate such critical information prior to making a voting decision.

E. Filing Obligations for Investment Companies

The Commission has proposed requiring shareholder proponents of investment company director nominees to rely on the investment company assets as provided by the company on Form N-CSR. (Shareholder proponents of other companies could rely on the company's Form 10-Q or 10-K.) The Institute supports the proposed approach.

The Commission also has proposed requiring any company that did not hold an annual meeting during the prior year, or that changed the date of its annual meeting by more than 30 days from the prior year, to disclose on Form 8-K the date by which a shareholder proponent must submit notice of its intent to require that the company include that shareholder proponent's nominee on the company's proxy statement. The proposal would apply the same Form 8-K filing obligations to investment companies. The Release explains that the reason for this requirement is to help to ensure that a company's shareholders are made aware of the date by which they must submit a notice of intent to nominate a director on the company's proxy statement.

With regard to the Form 8-K filing requirement, the Release requests comment on whether investment companies should be permitted to provide this disclosure in a different manner. The Institute strongly urges the Commission not to adopt a Form 8-K filing requirement for investment companies. As the Institute has pointed out previously,⁵⁵ investment companies typically are not required to file Form 8-K, and we do not believe it is necessary or appropriate to subject them to Form 8-K reporting for this purpose.⁵⁶ Rather, we recommend that the Commission require investment companies to inform shareholder proponents of the intent to nominate date through another method (or combination of methods) of disclosure that is reasonably designed to provide notice of the date to

⁵⁵ See, e.g., 2003 ICI Letter at pp. 11-12 and Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Dorothy M. Donohue, Associate Counsel, Investment Company Institute, dated December 13, 2002 (Institute comment letter regarding proposed Regulation Blackout Trading Restriction).

⁵⁶ For the same reasons, we oppose the requirement that any series company file a Form 8-K disclosing the company's assets and the total number of shares outstanding and entitled to be voted. We similarly recommend that the Commission instead require this disclosure to appear in a press release, on a website, or through another means of communication.

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their shareholders. Such methods could include, but would not be limited to, a press release or posting information on the company's website.⁵⁷

* * * *

We hope our comments will help the Commission to formulate a reasoned approach that accounts for the many complex and significant issues raised by amending the proxy rules to permit shareholder access to a company's proxy statement for the purpose of director nominations or related bylaw provisions. If you have any questions or need additional information, please contact me at (202) 326-5901, Karrie McMillan at (202) 326-5815 or Dorothy M. Donohue at (202) 218-3563.

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President and Chief Executive Officer

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

Andrew J. Donohue, Director
Susan Nash, Associate Director
Division of Investment Management

Meredith B. Cross, Director
Division of Corporation Finance

U.S. Securities and Exchange Commission

⁵⁷ The recommended approach is consistent with Rule 14a-5(f) which permits investment companies to inform shareholders of a change in meeting date in their shareholder report, or, if impracticable, by any means reasonably calculated to inform shareholders. It is also similar to Regulation FD, which gives companies the choice of making public disclosure of certain information by filing a Form 8-K with the Commission or by disseminating "the information through another method (or combination of methods) of disclosure that is reasonably designed to provide broad, non-exclusionary distribution of information to the public." See Rule 101(e) under the Exchange Act.