INVESTMENT COMPANY INSTITUTE

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May 13, 2021

Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to Be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners* (File No. SR-NYSE-2020-96)

Dear Ms. Countryman:

The Investment Company Institute[1] is filing this letter in response to the March order issued by the Securities and Exchange Commission (SEC or "Commission") instituting proceedings ("Order") regarding the New York Stock Exchange's (NYSE) proposed rule change on maximum fees to be charged by member organizations for forwarding proxy and other materials to beneficial owners.[2] Our January letter to the Commission[3] recommended that the Commission approve the NYSE's proposed rule change. We made this recommendation because under the proposed rule change FINRA (instead of the NYSE) would assume oversight of processing fees. Since then, however, FINRA has indicated that it has no interest in taking on this responsibility.[4]

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[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$29.8 trillion in the United States, serving more than 100 million US shareholders, and US$9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *Self-Regulatory Organizations; New York Stock Exchange LLC; Order Instituting Proceedings to Determine Whether to approve or Disapprove a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates To Be Charged By Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners* (File No. SR-NYSE-2020-96) (Release No. 34-91359); (March 18, 2021), *available at* https://www.sec.gov/rules/sro/nyse/2021/34-91359.pdf; 86 Fed. Reg. 15734 (March 24, 2021), *available at* https://www.govinfo.gov/content/pkg/FR-2021-03-24/pdf/2021-06000.pdf.

[3] Letter to Ms. Vanessa A. Countryman, Secretary, US Securities and Exchange Commission, from Dorothy M. Donohue, Deputy General Counsel, Securities Regulation, and Joanne Kane, Senior Director, Operations and Transfer Agency, Investment Company Institute, dated January 8, 2021, *available at* https://www.sec.gov/comments/sr-nyse-2020-96/srnyse202096-8221270-227699.pdf ("ICI January Letter").

[4] FINRA stated in its April letter to the Commission that "[w]e can firmly attest that we are not in [a better position to take the lead on these matters], regardless of suggestions otherwise." Letter to Vanessa Countryman, Secretary,

The fact that neither self-regulatory organization wants the responsibility for determining what constitutes reasonable fees is perhaps the best illustration of how the existing framework is fundamentally flawed. It is clear at this point that the only option is for the SEC, under Chair Gensler's leadership, to reform the broken, outdated processing fee framework. This action will benefit investment company shareholders, potentially saving them hundreds of millions of dollars.[5]

One action that the Commission could take in the near term would be to issue a statement reminding broker-dealers and their agents that the Securities Exchange Act of 1934 ("1934 Act") requires processing fees to be "reasonable" and that the mere existence of a fee schedule does not eliminate this overarching Commission requirement (*i.e.*, brokers and their agents may not charge funds the schedule's maximum fees if those fees are not "reasonable"). For example, we do not believe that it is reasonable for funds to be charged three to five times as much in processing fees for mailing the same shareholder report to an intermediary-held fund account as to a direct-held fund account. Following its issuance of a statement, the Commission should take additional steps to reform the fee schedule. We suggest a path forward on how to do so below.

Background

The NYSE's rule proposal would direct NYSE member organizations that also are FINRA member firms to comply with FINRA Rule 2251's fee schedule of approved charges for reimbursement rates for forwarding proxy and other materials to beneficial owners.[6] The NYSE proposal also would eliminate the existing NYSE fee schedule that is the corollary of the FINRA fee schedule. Following the SEC's publication of the proposed rule change in December 2020, in February 2021, the Commission designated a longer time period to consider the rule submission. In March, the Commission issued the Order to determine whether to approve or disapprove the proposed rule change.

Under NYSE Rules 451 and 465, NYSE member organizations are required to deliver proxy and other disclosure materials to beneficial owners, including fund shareholders, that hold shares in nominee name through an intermediary. In exchange for delivering these fund documents to shareholders, funds reimburse NYSE member organizations for out-of-pocket, reasonable clerical, postage, and other expenses, according to the NYSE fee schedule. The SEC explains

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Securities and Exchange Commission, from Marcia Asquith, Executive Vice President, Board & External Relations, FINRA, dated April 14, 2021, *available at* https://www.sec.gov/comments/sr-nyse-2020-96/srnyse202096-8670129-235464.pdf ("FINRA April Letter").

[5] For the sake of simplicity, we use "investment company" and "fund" interchangeably to refer to registered investment companies and their affiliated transfer agents and advisers throughout this letter.

[6] *See Self-Regulatory Organizations; New York Stock Exchange LLC; Notice of Filing of Proposed Rule Change Amending Its Rules Establishing Maximum Fee Rates To Be Charged By Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners* (File No. SR-NYSE-2020-96) (Release No. 34-90677); (December 15, 2020), *available at* https://www.sec.gov/rules/sro/nyse/2020/34-90677.pdf; 85 Fed. Reg. 83119 (December 21, 2020), *available at* https://www.govinfo.gov/content/pkg/FR-2020-12-21/pdf/2020-28010.pdf.

that this reimbursement structure stems from Rules 14b-1 and 14b-2 under the 1934 Act, which "do not specify the fees that nominees can charge issuers for proxy distribution; rather, they state that issuers must reimburse the nominees for 'reasonable expenses' incurred."[7]

Currently, funds almost always are charged the maximum rates in the NYSE fee schedule, reflecting the fact that intermediaries lack the incentive to negotiate lower rates for funds. In fact, certain intermediaries have a compelling incentive to *not* seek lower rates. For example, in situations in which an intermediary has negotiated processing fees that are lower than the NYSE maximum processing fees, the vendor typically does not charge the fund the lower, negotiated rate. Instead, the vendor invoices the fund for the maximum NYSE fee rate, and then "remits" the difference back to the broker. The concept of "remittances" is a stark example of the inequitable allocation of fees that takes place under the NYSE fee schedule. This practice results from the fact that the intermediary is negotiating a price that the fund must pay. In contrast, when funds negotiate with vendors on behalf of their direct-held accounts, the fund pays the negotiated rate which typically is lower than the NYSE fee schedule. Furthermore, the NYSE fee schedule includes a "preference management fee" which effectively charges a per-account fee to suppress hardcopy mailings for shareholders who have opted to receive fund materials electronically. The application of the preference management fee has consistently limited the potential cost savings that electronic delivery offers to fund shareholders.

As a result of these harmful billing practices, *funds pay three to five times as much to distribute materials through intermediaries as they pay to distribute those materials directly*, costs that ultimately are borne by fund shareholders.[8] This cost discrepancy demonstrates that the current processing fee framework is ill-suited to distribution of fund materials and the fees that apply to funds bear little relation to the actual work and cost of distributing fund materials. As a result, fees charged pursuant to the schedule are higher than necessary to compensate for reasonable delivery expenses.[9] This substantial fee differential is harmful to fund shareholders and anti-competitive, resulting in a processing fee framework fee that does not meet the statutory purpose underlying Rules 14b-1 and 14b-2 under the 1934 Act, which are the predicate for NYSE Rules 451 and 465.[10]

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[7] Order at 15735.

[8] *See* Letter to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission, from Susan Olson, General Counsel, ICI, dated October 31, 2018, *available at* https://www.ici.org/system/files/attachments/18_ici_processing_fees_ltr.pdf ("ICI 2018 Letter"); Letter to Mr. Brent J. Fields, Secretary, US Securities and Exchange Commission, from Shelly Antoniewicz and Joanne Kane, Investment Company Institute (Jan. 17, 2019), *available at* https://www.ici.org/system/files/attachments/18_ici_nysefees_ltr.pdf.

[9] *Id.*

[10] The statutory basis for Rules 14b-1 and 14b-2 includes Section 6(b)(5) of the 1934 Act. Section 6(b)(5) requires that 1934 Act rules "be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest." Section 6(b)(5) further requires that 1934 Act rules not be designed to permit unfair discrimination between customers, issuers,

The Commission Should Reform the Processing Fee Framework

The Commission is the only entity with the authority and broad perspective needed to reform the processing fee framework and determine the standards that should govern these fees.[11] We do not believe, as one commenter has suggested, that a broader industry discussion of these issues is necessary before the Commission takes action on processing fees. Further industry discourse on these issues is unlikely to be productive.[12]

We also are extremely concerned that another commenter's proposed resolution of this longstanding issue contemplates the SEC explicitly permitting brokers to charge fund shareholders *unreasonable* fees. In particular, this commenter recommends that "the Commission ensure that at least one significant SRO retains a fixed maximum fee schedule, *rather than deferring to the uncertainty of a 'reasonableness' standard without specific rates*."[13]

We recommend that, in the near term, the SEC issue a statement reminding broker-dealers and their agents that the 1934 Act requires processing fees to be "reasonable" and that the mere existence of a fee schedule does not eliminate this overarching Commission requirement (*i.e.*, brokers and their agents may not charge funds the schedule's maximum fees if those fees are not "reasonable").

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brokers, or dealers. *Self-Regulatory Organizations; New York Stock Exchange, Inc. Notice of Filing of and Order Approving Proposed Rule Change on an Accelerated Basis; Relating to proposed changes in NYSE Rules 451 and 455 concerning a surcharge* (File No. SR-NYSE-85-16) (Release No. 34-21966) (April 19, 1985).

[11] FINRA apparently shares this view, stating that "[w]e also agree with other commenters on the Proposal that the Commission is in the best position to determine what standards should govern broker-dealer fees for forwarding and processing proxy and other materials, and whether those fees should be subject to a maximum fee schedule similar to the fee provisions in NYSE Rule 451." FINRA April Letter.

[12] *See id;* Letter to J. Matthew DeLesDernier, Assistant Secretary, Securities and Exchange Commission, from Marcia Asquith, Executive Vice President, Board & External Relations, FINRA, dated January 11, 2021, available at https://www.sec.gov/comments/sr-nyse-2020-96/srnyse202096-8231370-227746.pdf. We note that FINRA previously recommended that the SEC, under former Chair White's leadership, conduct an industry roundtable. Since then, there have been a number of developments that make this type of approach less promising. For example, for approximately two years, industry participants have been trying to reach a compromise approach through a processing fee working group that was created at the Commission's direction in 2019. Due to the strongly held, irreconcilable views of the participants, it appears increasingly unlikely that the working group, despite much time and effort spent, will be able to reach consensus on a joint recommendation to the Commission. Based on this experience and prior efforts over the past ten years (including an NYSE-led industry working group that commenced efforts in 2012), we believe that additional industry discussions will result only in further delaying a resolution of these critical issues, to the detriment of fund shareholders.

[13] Letter to Ms. Vanessa Countryman, Secretary, Securities and Exchange Commission, from Thomas F. Price, Managing Director, Operations, Technology, Cyber & BCP, SIFMA, dated April 14, 2021, *available at* https://www.sec.gov/comments/sr-nyse-2020-96/srnyse202096-8671316-235482.pdf (*emphasis added*). We also disagree with SIFMA that a "one size fits all" cost structure is appropriate. The current fees under the NYSE fee schedule bear little relation to the actual work and cost of distributing fund materials. As a result, fees charged pursuant to the schedule are higher than necessary to compensate intermediaries for reasonable delivery expenses. *See* ICI 2018 Letter.

We also urge the Commission to reform the processing fee framework and more broadly the system for distributing fund materials to beneficial owners.[14] Only the Commission can independently assess, and make the judgments necessary to reform, the current system consistent with the public interest and investor protection. To facilitate greater competition with respect to processing fees, we recommend that the Commission permit funds to negotiate with vendors and eliminate the need for a fee schedule by either:

- Making clear that Section 14 rules under the 1934 Act permit funds to choose how to deliver fund regulatory materials and require intermediaries to provide to funds or their selected agent (*i.e.*, vendor), upon request, a data file with only the shareholder information necessary for delivering these materials; or
- Allowing funds to choose how to deliver fund regulatory materials by not applying the objecting beneficial owner (OBO)/non-objecting beneficial owner (NOBO) distinction for the purpose of distributing fund regulatory materials.[15]

If the Commission is unwilling to take either of these measures, it should reform the processing fee schedule itself by:

- Creating a fee schedule tailored to fund disclosure delivery obligations;[16]
- Replacing the existing layered fees with simple flat fees that reflect actual costs, using costs for direct-held fund accounts as a guide;
- Eliminating unreasonable billing practices, such as remittances and suppression fees, that maximize intermediary and vendor profit at fund shareholder expense;
- Creating a robust regulatory oversight framework; and
- Mandating a regular independent review of fee rates and vendor billing practices.

* * *

[14] Then Acting Chair Lee recently acknowledged these concerns, stating that:

> Funds as an issuer community face a unique landscape as their ownership is highly intermediated and diffuse, making it difficult and expensive to identify shareholders. This is coupled with the challenge that funds have in communicating directly with investors. These unique problems translate into increased expenses for funds to carry out their regulatory obligations to obtain shareholder approval for items such as a change in a fund's fundamental investment policy and certain agreements.

Acting Chair Allison Herren Lee, *Every Vote Counts: The Importance of Fund Voting and Disclosure* (March 17, 2021), *available at* https://www.sec.gov/news/speech/lee-every-vote-counts.

[15] *See* ICI 2018 Letter; *see also* ICI Processing Fees Resource Center, *available at* https://www.ici.org/pfrc.

[16] In developing an updated and tailored fee schedule, the Commission should engage a fully *independent* third party to comprehensively review the processing fees that funds are charged for delivery of fund materials, to ensure that the amount of the fees reflects the actual cost of the work, taking into account costs for direct-held accounts.

Please let us know if we may be of further assistance to the Commission on these issues. If you have questions or would like to discuss our comments, please contact Sarah Bessin at (202) 326-5835 or sarah.bessin@ici.org, or Joanne Kane at (202) 326-5850 or joanne.kane@ici.org.

Sincerely,

/s/ Sarah A. Bessin

Sarah A. Bessin
Associate General Counsel,
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/s/ Joanne Kane

Joanne Kane
Senior Director,
Operations and Transfer Agency

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw

Sarah ten Siethoff, Acting Director, Division of Investment Management
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