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December 19, 2016

Mr. Brent J. Fields  
Secretary  
US Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-9303

Re: *Proposed Rule: Universal Proxy* (File Number S7-24-16)

Dear Mr. Fields:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to provide its views on the Securities and Exchange Commission’s proposed amendments to the federal proxy rules that would mandate the use of universal proxies. In particular, companies other than registered investment companies and business development companies, would be required to use universal proxies for contested elections of directors at annual shareholder meetings.<sup>2</sup>

We have analyzed the proposal from two perspectives—funds as issuers with their own directors and shareholders, and funds as shareholders of the companies in which they invest.<sup>3</sup> As both issuers and investors, funds fully recognize the importance of effective corporate governance and also are cognizant of the need to avoid undue interference with a company’s management. As issuers, the Institute supports the SEC excluding funds from the proposed universal proxy rules. As investors, we

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<sup>1</sup> The Investment Company Institute (“ICI”) is a leading global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts 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\$18.2 trillion in the United States, serving more than 95 million US shareholders, and US\$1.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> *Proposed Rule: Universal Proxy*, SEC Rel. Nos. 34-79164, IC-32339 (Oct. 26, 2016), *available at* <https://www.sec.gov/rules/proposed/2016/34-79164.pdf>. Throughout this letter, we refer to registered investment companies and BDCs together as “funds” and to open-end funds as “mutual funds” when necessary to distinguish them from closed-end funds.

<sup>3</sup> As issuers, funds prepare proxy solicitation materials in connection with meetings of their shareholders. As investors, funds have specific responsibilities with respect to proxy voting.

anticipate that funds would find value in being able to use universal proxies.

The current proxy rules do not provide shareholders voting for directors through the proxy process with the same voting options as those available to shareholders voting in person at a shareholder meeting.<sup>4</sup> Shareholders voting in person at a meeting may select among all of the duly nominated director candidates that any party (*i.e.*, management or dissident) has proposed for election and may vote for any combination of those candidates. Shareholders voting by proxy, however, are limited to selecting among the candidates the party soliciting the shareholder's proxy provides on the proxy card. Shareholders that wish to vote for a mix of management and dissident nominees (*i.e.*, to "split their vote") can do so only by attending the shareholder meeting in person and voting their shares at that meeting.

The SEC's proposed universal proxy rules would align the manner in which shareholders vote by proxy with how shareholders vote in person at a shareholder meeting.<sup>5</sup> The SEC's proposal would do so by requiring each soliciting party in a contested election to distribute a universal proxy that includes the names of all candidates for election to the board of directors, which allows shareholders to vote for a mix of management and dissident nominees.<sup>6</sup>

From the perspective of funds as issuers, the SEC appropriately excludes funds from the universal proxy requirements, recognizing the many differences between funds and operating companies. We discuss below why the burdens of applying the universal proxy requirements to funds would greatly outweigh any benefits. In particular, we highlight four significant differences between funds and operating companies as follows:

- 1) Funds are subject to Investment Company Act of 1940 requirements that supplement state law and provide specific rights to shareholders to approve fundamental features of a fund;
- 2) Funds' governance structures, which differ from those of typical operating companies, would be disrupted by split-ticket voting;
- 3) Funds typically have a different shareholder base than operating companies that will cause them to incur greater solicitation costs from contested elections; and
- 4) Fund investors have little reason to call for split-ticket voting.

From the perspective of funds as institutional investors, funds would find value in the proposal's alignment of voting options, whether by proxy or in person. This alignment would allow

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<sup>4</sup> See Proposing Release at Section I.B.

<sup>5</sup> See Proposing Release at p. 9.

<sup>6</sup> See proposed Rule 14a-4.

funds to vote more easily for a mix of both management and dissident nominees, while still requiring a dissident shareholder to clear an appropriately high threshold to receive access to a company's universal proxy. For example, in order to access a company's universal proxy, the proposal would require the dissident to solicit shareholders representing at least a majority of the shares entitled to vote on the election of directors.<sup>7</sup> The proposal also would require the dissident to file its definitive proxy statement with the Commission within a certain timeframe.<sup>8</sup> These provisions should help ensure that dissidents do not use universal proxies to further their own parochial or short-term interests at the expense of the company's other shareholders.

## **I. Proposed Universal Proxy Appropriately Excludes Funds as Issuers**

Under the proposal, the SEC would not subject funds to the universal proxy requirements. The proposing release asks whether the proposal should be mandatory as applied to funds and whether the universal proxy would affect funds differently than operating companies. As explained more fully below, we strongly support the Commission's decision to exclude funds completely from the universal proxy requirements and believe that, because of the many differences between funds and operating companies, the proposed rules would impose much greater costs on funds with much less meaningful benefits.

### *A. Funds Are Subject to Investment Company Act Requirements*

First, funds are subject to Investment Company Act requirements that supplement state law and provide specific rights to shareholders to approve fundamental features of a fund. For example, under the Investment Company Act, funds must receive shareholder approval before entering into any investment advisory contract or making any material change to an investment advisory contract or fundamental investment policy. These rights, which are not available to shareholders of operating companies, empower fund shareholders, enabling them to participate in fund governance decisions that directors otherwise would make. The existence of such rights diminishes the need for fund shareholders to have access to universal proxies.<sup>9</sup>

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<sup>7</sup> See proposed Rule 14a-19.

<sup>8</sup> Dissidents would need to provide registrants with notice of intent to solicit proxies in support of nominees other than the registrant's nominees and the names of those nominees. Registrants would need to provide dissidents with notice of the names of the registrant's nominees. The proposed rules also would impose specific presentation and formatting requirements for all director election proposals on universal proxy cards.

<sup>9</sup> Registered investment companies are prohibited from engaging in a variety of transactions and activities unless they first obtain shareholder approval, including: 1) entering into a contract with an investment adviser, a principal underwriter or distributor (Section 15 of the Investment Company Act and Rule 12b-1 thereunder with respect to distribution agreements); or 2) changing from an open-end, closed-end or diversified investment company; borrowing money, issuing senior securities, underwriting securities issued by others, purchasing or selling real estate or commodities, or making loans to other persons, except in accordance with a policy in the registration statement; or deviating from a stated policy with

*B. Funds Have Unique Governance Structures*

Second, funds' governance structures, which differ from those of typical operating companies, would be disrupted by split-ticket voting. While operating companies typically have one board that is responsible for overseeing only that company's operations, multiple funds in a complex typically share a common board. A recent ICI and Independent Directors Council study of fund governance practices indicates that 86 percent of funds employ a "unitary board" structure in which a single board oversees all of the funds in the complex.<sup>10</sup> The remaining 14 percent of complexes employ a "cluster board" structure in which more than one board each oversees a designated group of funds in the complex.<sup>11</sup>

Virtually all funds use one of these two structures to leverage efficiencies of scale and because of the unique governance challenges in the fund industry. Unitary and cluster boards enhance fund governance. Because of the broad responsibilities that the Investment Company Act places on fund directors, experience and knowledge of fund operations are critical. Through their experience overseeing multiple funds in a complex, directors gain greater familiarity with the aspects of fund operations that impact the funds in the complex. These areas include oversight of common service providers, compliance policies and procedures, valuation and accounting practices, liquidity standards, and portfolio management practices. The standards that govern directors' determinations in these areas typically apply to other funds in the complex, and consistency among funds, including in their policies and procedures, greatly enhances both board efficiency and reduces the likelihood for compliance errors. Directors also gain greater access to and influence over the fund's adviser than if they represented fewer funds in the complex. Because they are negotiating on behalf of multiple funds, unitary and cluster boards have a greater ability than single fund boards to negotiate with management over matters such as fund expenses, the level of resources devoted to technology, and compliance and audit functions.

In addition to performing general oversight, fund directors also are required to perform the many duties the Investment Company Act delineates. For example, fund directors must annually review a fund's contract with its investment adviser and must request and evaluate information

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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 nature of its business so as to cease being an investment company (Section 13 of the Investment Company Act).

<sup>10</sup> See Independent Directors Council and the Investment Company Institute, Overview of Fund Governance Practices, 1994-2014 (2015), available at [https://www.ici.org/pdf/pub\\_15\\_fund\\_governance.pdf](https://www.ici.org/pdf/pub_15_fund_governance.pdf). Some advisers have used a variation of the unitary board model in which several third-party service providers offer smaller advisers the option of having their fund join a "shared trust" and pay a fee in exchange for receiving fund start-up and organization services, fund administration, fund distribution, fund accounting, and pricing, transfer agent and other shareholder services. Funds that are members of the same trust share these ongoing costs, permitting fund managers to concentrate on managing fund assets. Shared trusts typically have one board that oversees all funds that participate.

<sup>11</sup> Clusters may be organized according to investment objective, investment sector, or result from a merger of complexes that were initially organized under separate management.

reasonably necessary to evaluate the advisory contract.<sup>12</sup> While the annual contract approval process usually culminates in one or more meetings specifically dedicated to the decision, the board's work throughout the year—monitoring investment performance, overseeing compliance and risk management, assessing the quality of the adviser's services, and other matters—informs this approval process. As a consequence of this and other board responsibilities, board meetings are lengthy (typically lasting a day or two) and require review of, often times, voluminous and complex materials. Bringing multiple funds under the same board enables boards to efficiently meet these challenges for each fund in the complex.

Because the structures enable fund directors to oversee multiple funds with common operational and administrative processes and common third-party service providers and given the unique and enhanced responsibilities for fund directors, funds gain tremendous operational efficiencies when they allow one board to serve across multiple funds in a complex. These efficiencies include concurrent meetings, combined board materials, and reduced meeting fees and travel expenses. In addition, fund management can avoid having to make repetitive presentations. Unitary and cluster boards, thus, reduce costs for funds, and ultimately, their shareholders.

A split-ticket that results in dissident directors joining a fund board inherently would disrupt the efficient and widespread practice of having unitary and cluster boards at funds.<sup>13</sup> Rather, a mixed board would oversee certain funds, while the original unitary or cluster board would oversee other funds.<sup>14</sup> Funds with unitary or cluster board structures would be forced to make costly and disruptive changes for board meetings to accommodate a mixed board. Combined meetings and board materials would no longer be possible, as dissident nominees would have to leave during discussions pertaining to

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<sup>12</sup> See Section 15(c) of the Investment Company Act.

<sup>13</sup> In order to rely on one of several exemptive rules on which funds typically rely, the SEC requires that incumbent independent directors of funds select and nominate other independent directors of the fund. See, e.g., Rule 10f-3(c)(11) under the Investment Company Act (requiring funds relying on Rule 10f-3 under the Investment Company Act to adhere to the fund governance standards set forth in Rule 0-1(a)(7) under the Investment Company Act); Rule 0-1(a)(7) under the Investment Company Act (requiring independent directors of funds to select and nominate other independent directors). When making these selections and nominations, incumbent independent directors typically look beyond simple legal requirements and identify individuals who have the background, experience, and independent judgment to represent diligently the interests of fund investors. Importantly, they also search for directors who are the "right fit" for the incumbent board, including with respect to background, experience, and collegiality. The use of universal proxies has the potential to disrupt these beneficial practices.

<sup>14</sup> A dissident joining a fund board also may raise compliance issues for funds. Section 10(a) of the Investment Company Act requires at least 40 percent of a fund's board to be independent directors. In addition, the SEC has conditioned several of its commonly-used exemptive rules on fund boards having a majority of independent directors. Theoretically, a dissident nominee could be deemed to be an "interested person" under Section 2(a)(19) of the Investment Company Act (e.g., if he or she owned 5 percent or more of a fund's shares) and, therefore, would not qualify as an independent director of the fund. Accordingly, it is possible that the nomination and election of a dissident nominee who is an interested person of the fund would cause a fund to fail to meet the required percentage of independent directors necessary to operate or to rely on certain exemptive rules.

other funds and customized board materials would have to be provided for each board.<sup>15</sup> Additionally, funds would have to change the logistics of board meetings and management and others would be forced to make repetitive presentations to additional boards. Split-ticket voting, therefore, could lead funds to experience additional administrative complexities and redundancies, generating additional costs that their shareholders would bear.<sup>16</sup>

### *C. Funds Have Different Shareholder Bases than Operating Companies*

To the extent that mandating universal proxies leads to more contested elections, funds' largely retail shareholder base will cause them to incur greater solicitation costs from contested elections than operating companies. A recent ICI report shows that retail investors hold approximately 89 percent of mutual fund assets.<sup>17</sup> Our members indicate that retail investors hold the vast majority of closed-end fund shares. In contrast, retail investors hold approximately 30 percent of the aggregate value of operating companies' publicly traded stock.<sup>18</sup>

Retail investors tend to have smaller holdings than institutional investors and, therefore, shares of funds are more dispersed than shares of operating companies. Funds, therefore, typically must engage proxy solicitors at great expense to their shareholders to locate, contact, and provide alternate means of voting (*e.g.*, telephone voting) to their investors to solicit proxies for any matter that is deemed to be non-routine, such as a contested election.

### *D. Funds Do Not Need Split-Ticket Voting*

Fund investors have little reason to call for split-ticket voting. Universal proxies are unnecessary for mutual funds because they are not required to have annual meetings, rarely hold

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<sup>15</sup> Unitary and cluster boards typically are provided with aggregate data for all of the funds they oversee, which they use to conduct their review. They typically apply one set of procedures to all funds they oversee. This process would need to be tailored for different boards, each of which might contain confidential, fund-specific information.

<sup>16</sup> These costs could be exacerbated for smaller funds that do not benefit from the same economies of scale available for larger funds. To avoid increasing expense ratios, small fund advisers may pay costs out of their own pockets that typically are charged to the funds. If small fund advisers were no longer able to utilize a unitary or cluster board arrangement (including sharing a trust and common board with unrelated funds), they may be compelled to absorb these additional costs, squeezing their profit margins further. The expected smaller rate of return may dissuade entrepreneurs from entering into the investment company industry, and force the exit of some other fund advisers.

<sup>17</sup> See ICI, 2016 Investment Company Fact Book (2016) at 29, available at [https://www.ici.org/pdf/2016\\_factbook.pdf](https://www.ici.org/pdf/2016_factbook.pdf)

<sup>18</sup> ICI's estimate of retail holdings of operating companies is based on data from *Financial Accounts of the United States* (published by the Federal Reserve Board) (Sept. 2016). This result is consistent with the SEC's finding that institutional investors held 68 percent of shares in brokerage accounts for U.S. public companies that held their annual meetings between January 2015 and June 2015. See Proposing Release at n. 218.

director elections, and are transacted at net asset value.<sup>19</sup> Without a requirement to hold annual meetings, mutual fund director elections are very infrequent.<sup>20</sup> When mutual funds do seek shareholder approvals for director nominees, the elections typically do not involve contests between directors because those funds sell and redeem shares at NAV. With no opportunity to profit from a “discount” between the market price of a mutual fund’s shares and its NAV, dissidents have little incentive to nominate directors or otherwise take steps to influence the management of mutual funds.<sup>21</sup>

Similarly, universal proxies are unnecessary for closed-end funds and BDCs, because, in an attempt to profit from narrowing the discount, dissidents in those funds historically have recommended specific proposals rather than simply providing director nominees, or have nominated a full slate of directors. Specifically, although closed-end funds and BDCs are required to hold annual meetings each year and vote on directors at those annual meetings,<sup>22</sup> dissidents often will recommend other more direct, discount-reducing mechanisms.<sup>23</sup> In most situations, the dissident does not want to

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<sup>19</sup> At the end of 2015, the open-end fund and exchange-traded fund market accounted for greater than 98 percent of assets under management. See ICI, 2016 Investment Company Fact Book (2016) at 8, *available at* [https://www.ici.org/pdf/2016\\_factbook.pdf](https://www.ici.org/pdf/2016_factbook.pdf). In enacting the Investment Company Act, Congress considered requiring that registered investment companies hold annual meetings, but ultimately declined to take that approach. See Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before the House Subcomm. on Interstate and Foreign Commerce, 76th Cong., 3d Sess. 43 (1940) at 502 (testimony of Merrill Griswold, Chairman, Massachusetts Investors Trust of Boston) (noting that the initial bill proposed to give shareholders the right to elect directors at annual meetings). The SEC staff confirmed that the Investment Company Act does not impose a requirement to hold annual meetings in a 1986 no-action letter and took the position that the necessity for annual meetings was generally a question of state law. See John Nuveen & Co. Inc. (pub. avail. Nov. 18, 1986). The vast majority of funds are organized under Delaware, Maryland or Massachusetts law, which do not have annual meeting requirements.

<sup>20</sup> As the SEC points out, the SEC staff is not aware of any director election contests involving open-end funds dating back to 2000. See Proposing Release at n. 182.

<sup>21</sup> Unlike closed-end funds, BDCs and other types of securities, mutual fund shares are not “traded” and there is no market price for those shares. Instead, mutual funds purchase and sell their shares at NAV and a shareholder that sells or “redeems” his or her shares is entitled to receive his or her approximate proportionate share of the mutual fund’s current net assets or the cash equivalent thereof. See Section 2(a)(32) of the Investment Company Act (defining “redeemable security”). Exchange-traded funds generally trade at or near their NAV because their shares are redeemable by authorized participants and other market participants, whose arbitrage activities keep market prices at or near those levels.

<sup>22</sup> Although the Investment Company Act and state laws do not require funds to hold annual meetings, stock exchanges upon which closed-end funds and BDCs are listed do. See, e.g., NYSE Listed Company Manual §3.02, *available at* [http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp\\_1\\_4&manual=%2Ficm%2Fsections%2Ficm-sections%2F](http://nysemanual.nyse.com/LCMTTools/PlatformViewer.asp?selectednode=chp_1_4&manual=%2Ficm%2Fsections%2Ficm-sections%2F).

<sup>23</sup> There are several direct proposals that dissidents can make to reduce a fund’s discount. These include: “open-ending” closed-end funds and BDCs so that investors can redeem their shares directly from the fund at NAV to capture any difference between the shares’ market price and NAV; merging closed-end funds and BDCs with other similar funds to gain the benefits of “economies of scale;” forcing funds to implement a share repurchase program and retiring shares purchased at discounts; conducting a tender offer in which investors can sell some or all of their holdings at a price close to NAV; forcing funds to adopt an interval structure in which closed-end funds hold regularly scheduled tender offers for pre-determined

obtain board seats but prefers a settlement which results in some action that delivers NAV for some or all shares.<sup>24</sup> In fewer instances, dissidents will nominate a full slate of eligible nominees to seek control of the board and enact their changes. In those cases, as the SEC points out, dissidents rarely have nominated less than a full slate of directors—only doing so once in calendar years 2014 and 2015.<sup>25</sup> Any dissident proposal or nominee will represent a binary choice for shareholders to either vote with fund management or against it. Fund shareholders sympathetic to a dissident’s cause likely will vote the entire dissident’s slate on the dissident’s proxy card to maximize the probability that the dissident’s nominees will prevail and exact the changes proposed. With such stark choices between management and dissidents, there is no need to apply any universal proxy requirements to closed-end funds and BDCs.

## **II. Proposed Universal Proxy Would Provide Value to Funds as Institutional Investors**

Proxy voting also is important to funds in their role as institutional investors in operating companies. As institutional investors seeking to maximize value for their shareholders, funds have specific responsibilities with respect to proxy voting. In addition, because they frequently hold large positions in the companies in which they invest, funds are aware that their votes may significantly affect the outcome of particular voting matters. Permitting funds to vote more easily for a mix of both management and dissident nominees would provide them with a new valuable corporate governance tool.

Funds generally do not undertake dissident proxy solicitations. Funds may vote for dissident nominees, however, from time to time. Under the current system, funds that wish to vote for a mix of registrant and dissident nominees can do so only by attending the shareholder meeting in person and voting their shares at that meeting. In effect, a fund must bear the cost of sending a representative to the shareholder meeting in order to gain the option to split its vote. Universal proxies would enable funds to vote by proxy for their preferred combination of nominees without incurring the additional cost of attending the shareholder meeting in person.

At the same time, we support the SEC’s proposal to limit practically the dissident’s “access” to the listing of nominee names on the universal proxy card by requiring the dissident to solicit on behalf of its own nominees.<sup>26</sup> Without this obligation, dissident shareholders more easily could use the

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percentages of shares at prices close to NAV; and/or forcing funds to add a managed or level payout policy prescribing fixed monthly or quarterly distribution levels (usually calculated as a percentage of NAV).

<sup>24</sup>Based on information from two proxy information services, in fiscal year 2015, the majority of closed-end fund proxy contests that those services covered resulted in the dissident withdrawing or settling with the fund (10 out of 14 contests).

<sup>25</sup>See Proposing Release at nn. 182 and 368 and accompanying text.

<sup>26</sup>To do so, the dissident shareholder must undertake the time, effort and cost of preparing and filing a preliminary proxy statement; complete the staff review process; prepare and file a definitive proxy statement within a prescribed timeframe; and solicit the holders of shares representing at least a majority of the voting power of shares entitled to vote on the election of directors.



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company's proxy machinery to further parochial or short-term interests that the company's other shareholders do not share. We recognize the need for a company's board to represent effectively the company's shareholders, and the SEC's proposal balances this with an interest in promoting efficient and effective corporate governance.

In general, the adoption of a mandatory universal proxy for operating companies would serve the public interest in giving all shareholders the same voting options, whether they vote by proxy or in person. Funds, like other institutional investors, use a variety of methods to enhance shareholder value. The ability to vote more easily for a mix of management and dissident nominees could prove to be a useful additional tool for this purpose.

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We appreciate the opportunity to comment on the proposed rules. If you have any questions regarding our comments or would like additional information, please contact me at (202) 218-3563 or [ddonohue@ici.org](mailto:ddonohue@ici.org).

Sincerely,

/s/Dorothy M. Donohue

Dorothy M. Donohue  
Deputy General Counsel

cc: The Honorable Mary Jo White, Chair  
The Honorable Michael S. Piwowar  
The Honorable Kara M. Stein  
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