

Analysis of Fund Proxy Campaigns: 2012–2019

DECEMBER 2019

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I. Executive Summary

Multiple legal and regulatory provisions govern the shareholder meeting and approval requirements for registered investment companies (“funds”), including the Investment Company Act of 1940 (“1940 Act”). The 1940 Act and certain rules thereunder require the “vote of a majority of the outstanding voting securities of a company” (“1940 Act Majority”) to approve several specified items, including changes to fundamental investment policies, investment advisory and distribution agreements, Rule 12b-1 plans, and mergers of affiliated funds (collectively, “1940 Act Majority Items”). The 1940 Act Majority standard requires funds to obtain a quorum of greater than 50 percent to approve these Items. Fund shareholders also vote on nominees to the fund board and other matters, with these requirements more strongly shaped by state law and the terms of the funds’ organizational documents.

Funds face unique and daunting challenges when seeking to obtain quorum and shareholder approvals, primarily due to:

- » Funds’ diffuse and retail-oriented shareholder bases;
- » Retail shareholders’ relatively low proxy participation rates; and
- » Severe and costly impediments that limit funds’ ability to communicate directly with their shareholders.

ICI’s June 2019 letter to the SEC detailed these challenges and offered several recommendations for improving the fund proxy system.¹ Most notably, we recommended creating a new third way—to complement the existing statutory ways—for a fund to approve 1940 Act Majority Items. Compared to the statutory methods, ICI’s recommendation couples a lower quorum requirement (more than 33⅓ percent) with a higher affirmative vote requirement (at least 75 percent) (the “Supermajority Recommendation”).

Following that June Letter, ICI conducted a member survey on funds’ proxy experiences over the past seven years. The survey was designed to provide more granular information about funds’ 1940 Act Majority Items; the costs of their related proxy campaigns; and the anticipated effects of ICI’s Supermajority Recommendation.

¹ See Letter from Paul Schott Stevens, President and CEO, ICI, to Ms. Vanessa Countryman, Acting Secretary, SEC, dated June 11, 2019 (“June Letter”), available at www.sec.gov/comments/4-725/4725-5658296-185774.pdf.

Sixty-four ICI member firms responded, representing over \$18 trillion, or approximately 76 percent, of US-registered fund assets. The survey results illustrate the importance of reform and how ICI's recommendations would benefit funds and their shareholders. More specifically, the results demonstrate that:

- » Funds are experiencing significant costs and challenges when seeking shareholder approvals.
 - » Cost estimates for 145 separate campaigns totaled \$373 million.
 - » Twenty-two campaigns had costs greater than or equal to \$1 million.
 - » Eight had costs greater than or equal to \$10 million.
 - » The most expensive campaign was \$107 million.
 - » This \$373 million total *understates* industrywide proxy costs because:
 - » Not all fund complexes completed the survey.
 - » Of those that did, the survey did not capture *all* of respondents' proxy costs over this period (respondents provided information limited to *five* 1940 Act Majority Items and their related campaigns, and did not provide cost information for campaigns consisting solely of non-1940 Act Majority Items, such as director elections).
 - » Most respondents did not report *internal* proxy campaign costs (*e.g.*, personnel time spent preparing proxy materials, assisting with solicitation strategy, providing in-house legal assistance, and overseeing and coordinating efforts with third parties).
 - » Thirty-eight percent of reported proposals required at least one meeting adjournment to reach quorum, meaning that the affected fund(s) had to reconvene the meeting at a later date (in some cases, multiple times) to resolve the proxy matter.
- » The proxy system's high costs and challenges are disproportionately affecting decisions related to fund policies, governance, and operations.
 - » Seventy-seven percent of respondents indicated that they would consider changing at least one of their funds' existing fundamental policies if they could do so with board approval and advance shareholder notice in lieu of a proxy.
 - » Forty percent indicated that the proxy process impeded the fund complex's decision, including how and when, to add new board members.
 - » Thirty-six percent indicated that the costs of the proxy process had led them to liquidate funds in lieu of other alternatives (*e.g.*, a shareholder-approved merger).
 - » Fifty percent indicated that the high costs of the proxy process deterred the fair consideration of other beneficial actions.

- » ICI's Supermajority Recommendation would significantly reduce overall proxy campaign costs, by greatly reducing follow-up solicitation costs.
 - » Of the \$373 million in total proxy campaign costs, the high-end estimate of follow-up solicitation costs was \$229 million (or 61 percent of total campaign costs), and the low-end estimate was \$158 million (or 42 percent of total campaign costs).
- » *Voting* shareholders overwhelmingly support funds' proxy proposals, underscoring that the fund proxy system itself—not the nature of the proposals—drives these costs and challenges for funds.
 - » Despite funds' challenges in reaching quorum (which funds sometimes overcome only by spending significant money and using internal resources), fund shareholders ultimately approve 95 percent of 1940 Act Majority Items.
 - » *Voting* shareholders strongly favor 1940 Act Majority Items by wide margins, with an average of 85 percent of shares represented at shareholder meetings voting "for" these Items. Excluding abstentions and broker non-votes, the average percentage of votes cast "for" these Items jumps to 94 percent.
- » Nearly 85 percent of funds would benefit from ICI's Supermajority Recommendation because the quorum requirements in most funds' organizational documents are consistent with the Recommendation. Furthermore, ICI's Recommendation is consistent with the laws of Delaware, Massachusetts, and Maryland—the states in which 94 percent of funds are organized and operate.

Finally, additional cost savings would be realized for funds and their shareholders if the SEC were to follow ICI's other recommendations to:

- » Permit funds greater freedom to link in proxy statements to more extensive information;
- » Reform processing fees; and
- » Create alternative means for funds to change fundamental policies or hire sub-advisers without shareholder approval.

II. Background and Description of ICI's Proxy Recommendations

Multiple legal and regulatory provisions govern funds' shareholder meeting and approval requirements,² including the 1940 Act. The 1940 Act and certain rules thereunder require a 1940 Act Majority³ to approve:

- » Changes to fundamental investment policies;
- » Investment advisory and principal underwriting agreements (or amendments thereto);
- » Certain distribution arrangements (so-called "Rule 12b-1" plans) (or amendments thereto); and
- » Mergers of affiliated funds (collectively, "1940 Act Majority Items").⁴

Fund shareholders also vote on nominees to the fund board.⁵ Apart from what the 1940 Act requires, other potential changes (e.g., amendments to a fund's organizational documents) also may require shareholder approval, as set forth under state law, applicable listing standards (e.g., for ETFs and closed-end funds), and a fund's organizational documents.

Funds face daunting challenges when seeking to obtain quorum and shareholder approvals, primarily because:

- » Funds have diffuse and retail-oriented shareholder bases.
 - » Collectively, funds have over 100 million shareholders.⁶
 - » Retail investors (i.e., households) held the vast majority (89 percent) of the \$17.7 trillion in mutual fund total net assets at year-end 2018.⁷

² These include state law, provisions of a fund's organizational documents, and/or listing standards, if applicable.

³ Section 2(a)(42) defines this as "the vote, at the annual or a special meeting of the security holders of such company duly called, (A) of 67 per centum or more of the voting securities present at such meeting, if the holders of more than 50 per centum of the outstanding voting securities of such company are present or represented by proxy; or (B) of more than 50 per centum of the outstanding voting securities of such company, whichever is the less." Funds generally obtain approvals by achieving at least 67 percent support from greater than 50 percent of shares outstanding, and unless otherwise noted, we focus on that approval method in this report.

⁴ 1940 Act Sections 13(a), 15(a) and (b), and Rule 12b-1(b)(1) and Rule 17a-8 thereunder, respectively. Rule 17a-8 (mergers of affiliated investment companies) requires the merging fund's shareholders to approve the merger with a 1940 Act Majority unless the proposed transactions satisfies several conditions.

⁵ Section 16(a) of the 1940 Act requires shareholder approval of at least two-thirds of a fund's directors. The Act also requires shareholders to ratify or reject a fund's independent public accountant, although subsequent rulemaking largely has obviated this requirement. See Section 32(a)(2) and Rule 32a-4 thereunder, which exempts funds from this shareholder voting requirement, provided they satisfy certain audit committee-related requirements.

⁶ Investment Company Institute. 2019. *2019 Investment Company Fact Book: A Review of Trends and Activities in the Investment Company Industry*, at 30, available at www.icifactbook.org.

⁷ *Id.* at 58. Mutual funds held as investments in individual retirement accounts, defined contribution retirement plans, variable annuities, 529 plans, and Coverdell education savings accounts are counted as household holdings of mutual funds.

- » Retail investors are far less likely to vote proxies than institutional investors.⁸
 - » Over the past five years, shareholder voting trends have held steady for public companies generally, with retail investors generally voting less than 30 percent of their shares (28 percent in 2019) and institutional shareholders voting approximately 90 percent of their shares.⁹
- » Funds must overcome, at great expense, legal and other impediments to communicating directly with their shareholders.
 - » Fund ownership is highly intermediated, and SEC rules prohibit funds from contacting directly their “objecting beneficial owners” (OBOs). This means that a fund may not know the identities of a large percentage of its shareholders.
 - » Individuals’ changing communication preferences generally make them harder to reach and less responsive once reached.
 - » Federal law greatly impedes funds from contacting shareholders through their cell phones (assuming funds have this information) unless the shareholder previously has consented to that form of contact.¹⁰
 - » Together with shareholders’ transition to cell phones from landlines, it is harder for funds to reach their shareholders by phone (e.g., cell phone users typically do not answer calls from unknown numbers).
 - » Even when shareholders answer, they are much more skeptical (e.g., many believe that calls from unknown entities such as proxy solicitors are scams).

These factors contribute significantly to the costs and effort required to seek and obtain shareholder approvals for fund matters. Our June Letter highlighted these challenges in more detail, buttressed with public data and a 2018 member survey on proxy voting.¹¹

⁸ See generally *Statement Announcing SEC Staff Roundtable on the Proxy Process*, SEC Chairman Jay Clayton (July 30, 2018), available at www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process.

⁹ *ProxyPulse*, 2019 Proxy Season Review, at 5, available at www.broadridge.com/_assets/pdf/broadridge-proxypulse-2019-review.pdf.

¹⁰ See Telephone Consumer Protection Act of 1991 (“TCPA”), 47 U.S.C. § 227. The TCPA generally prohibits the use of certain kinds of automated dialing equipment (“robo-calling”) to call or text wireless telephone numbers absent advance consent.

¹¹ June Letter at 2-6. The June Letter summarized results from ICI’s 2018 survey on fund proxy campaigns. Compared to our Fall 2019 survey, however, the 2018 survey asked generally about *all* recent proxy campaigns (including those relating to recurring items like director elections) occurring in 2017 and 2018.

To address these intractable difficulties, our June Letter recommended that the SEC:

- » Reevaluate the 1940 Act’s shareholder approval requirements, particularly for those 1940 Act Majority Items where safeguards other than shareholder voting would protect investors’ interests at a lower cost. For instance, funds should be permitted to:
 - » Change fundamental policies¹² that are not material to a fund’s investment strategies or risks, subject to board approval and advance shareholder notice; and
 - » Hire sub-advisers, subject to the types of conditions in the SEC’s “manager of managers” exemptive relief.
- » Use its exemptive authority to create a new third way—to complement the existing two statutory ways—for a fund to approve remaining 1940 Act Majority Items.¹³
- » Revise proxy disclosure requirements to permit greater use of layering and linking in proxy statements, which would make materials more readable and reduce printing and mailing costs for multi-fund proxy statements in particular.

Notably, subsequent to that Letter, a large broker-dealer announced that it would no longer vote its customers’ shares on a discretionary basis, making the need for regulatory reform more pressing.

NYSE Rule 452 permits NYSE members to vote customers’ shares without customer instruction for “routine” matters including funds’ director elections,¹⁴ but does *not* permit members to vote customers’ shares for any “non-routine” matters (including all 1940 Act Majority Items) without instruction. Broker discretionary voting is a critical tool for routine and non-routine proposals alike:

- » For routine proposals, these broker votes (which may be cast “for” a proposal) help funds achieve quorum and shareholder approvals.
- » For non-routine proposals, broker participation still is helpful, even though the broker does not vote “for” or “against” such matters, but rather submits “non-votes” for them. Non-routine items are sometimes paired with routine items within a single fund proxy campaign. For such a campaign, broker voting on any routine matter helps a fund achieve quorum at the shareholder meeting, which is

¹² Section 13(a) of the 1940 Act states that no fund shall, unless authorized by the vote of a majority of its outstanding voting securities, (i) change its subclassification as an open-end or closed-end fund, or its subclassification from a diversified to a non-diversified company; (ii) borrow money, issue senior securities, underwrite securities issued by other persons, purchase or sell real estate or commodities or make loans to other persons, except in each case in accordance with the recitals of policy contained in its registration statement in respect thereto; (iii) deviate from its industry concentration policy as recited in its registration statement, deviate from any investment policy which is changeable only if authorized by shareholder vote, or deviate from any policy recited in its registration statement pursuant to Section 8(b)(3); or (iv) change the nature of its business so as to cease to be an investment company.

¹³ Compared to the statutory approval methods, we recommend a new method that couples a lower quorum requirement (more than 33⅓ percent) with a higher affirmative vote requirement (at least 75 percent). Appendix A explains this Supermajority Recommendation in greater detail.

¹⁴ This is referred to as “discretionary voting.”

a necessary prerequisite for achieving approval of non-routine items as well. In those circumstances, customers' shares are present at the meeting, irrespective of whether the broker voted on all proposals at that meeting.¹⁵

This one large broker's decision not to vote will affect funds differently, based on the number of beneficial owners that hold fund shares through that broker. Yet if other brokers (especially larger brokers) follow this large broker's lead and choose not to exercise their discretionary voting authority (or are acquired by brokers with more restrictive proxy voting practices), the utility of this tool will be seriously undermined.¹⁶ There also would seem to be economic logic to such a decision, as it would seem to eliminate any administrative costs or burdens associated with discretionary voting. This approach in turn will increase the time and cost—and in some cases, adversely affect funds' basic *ability*—to elect directors and approve other items.

Brokers are not the only intermediaries whose inaction may adversely affect fund proxy campaigns. Our members report difficulties in obtaining proxy participation from retirement plans, which are often large holders of mutual fund shares. By default, the duty to vote such proxies lies with the plan trustee or named fiduciary, although this duty can be delegated to investment managers.¹⁷ Many defined contribution plans—through the plan document—pass the proxy voting responsibility to the plan's participants. Where plan participants hold voting rights, funds' challenges are similar to those presented by retail investors generally (*i.e.*, their voting participation rates are relatively low). When plan fiduciaries assume the duty to vote proxies, additional considerations can dissuade them from voting.¹⁸

Finally, there is little reason to believe that the relatively low proxy participation rate among funds' retail shareholders will rebound any time soon. One member recently conducted a proxy campaign for its target date funds, featuring a 1940 Act Majority Item. Target date funds are unique in that they are heavily retail-owned, and those retail investors self-sort by age depending on their anticipated retirement dates (*e.g.*, older shareholders may invest in "2020" funds, while younger shareholders may invest in "2050" funds). Thus, proxy campaigns for target date funds provide interesting insights into voting behavior. In this case, proxy participation rates were *lower* for those funds with younger

¹⁵ See Appendix A for a description of broker non-votes and how they affect 1940 Act Majority votes.

¹⁶ Most fund shares are held through intermediaries. If brokers choose not to vote on routine items like director elections, funds would have to increase their follow-up solicitations of beneficial shareholders to reach quorum, adding delay and cost to proxy solicitations. See generally *Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors* (Dec. 18, 2006), available at www.ici.org/pdf/wht_broker_voting.pdf.

¹⁷ *Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines*, DOL Interpretive Bulletin 2016-01, 81 Fed. Reg. 95879 (Dec. 29, 2016) ("DOL IB 2016-01").

¹⁸ According to DOL IB 2016-01, plan fiduciaries are generally required "to vote proxies on issues that may affect the value of the plan's investment" but also give consideration to whether the plan's vote "is expected to have an effect on the value of the plan's investment that warrants the additional cost of voting." Therefore, the lack of voting that our members report may be the result of the legitimate belief of plan fiduciaries that the vote will not affect the value of the fund, or that the efforts that would be required to determine which vote is in the best interests of the plan participants would not merit the cost.

shareholders. While most of the target date funds designed for investors who were past their target retirement dates reached quorum with a single round of proxy solicitation, target date funds designed for much younger investors (*i.e.*, those with target retirement dates of 2050 and beyond) required multiple additional solicitations to reach quorum. Such behavior may be affected by several factors, including age, asset balances, and employment status/proximity to retirement. This example portends that today's overall low retail voting rate likely does not represent a floor.

III. Description of Survey

ICI's Fall 2019 member survey asked specifically about 1940 Act Majority Items on which shareholders voted over the past seven years. Sixty-four ICI member firms responded, representing over \$18 trillion, or approximately 76 percent of US-registered fund assets, as of June 30, 2019. The survey asked respondents to provide data regarding:

- » Total costs of proxy campaigns that included at least one 1940 Act Majority Item (145 total campaigns),¹⁹ and the estimated percentages of these totals attributable to follow-up solicitations (*e.g.*, costs associated with follow-up mailings, emails, and phone calls);
- » The impact that ICI's Supermajority Recommendation would have had on those campaigns;
- » The effects of the fund proxy process (including its costs and challenges) on fund policies, governance, and fund liquidations;
- » Specific 1940 Act Majority Items on which shareholders voted (*e.g.*, ultimate outcomes and degree of support) over the past seven years (208 total Items);²⁰ and
- » The default minimum quorum requirement for shareholder meetings in funds' organizational documents.

The reported proxy costs *understate* industrywide proxy costs over the past seven years because:

- » Not all fund complexes completed the survey.
- » Of those that did, the survey did not capture *all* of respondents' proxy costs over this period:
 - » To reduce the survey's burden, we asked respondents to provide information limited to *five* 1940 Act Majority Items and their related campaigns, which for some respondents represented only a portion of their proxy activity during that period; and

¹⁹ The number of campaigns is smaller than the number of 1940 Act Majority Items because some campaigns had multiple Items.

²⁰ Most respondents provided complete information for the requested Items (including the related cost information), although in a few cases respondents did not (we note such cases in this report).

- » Our survey did not capture cost information for proxy campaigns consisting solely of non-1940 Act Majority Items, such as director elections.
- » Most respondents did not report *internal* proxy campaign costs (e.g., personnel time spent preparing and delivering proxy materials, assisting with solicitation strategy, providing in-house legal assistance, and overseeing and coordinating efforts with third parties such as outside counsel, proxy solicitors, and mail vendors) or the related opportunity costs (e.g., diversion of resources that would have otherwise been employed elsewhere).

We also conducted over 40 follow-up calls with individual members to better understand their proxy experiences. We summarize our key findings below.

IV. Key Findings from Survey and Member Outreach

Significant challenges and costs accompany the fund proxy process. Typically, these difficulties arise not from insufficient support from those shareholders who vote (see Section IV.C below), but from lack of overall and sufficiently prompt voting activity among shareholders generally. In short, the significant effort needed to reach quorum often drives these costs and challenges.

ICI's Supermajority Recommendation would be broadly beneficial, with benefits scaling up (in both absolute dollars and percentages terms) for larger, more expensive campaigns, due to typically substantial follow-up solicitation efforts. ICI's other recommendations in the June Letter, if enacted, would further reduce costs.

We present survey questions below in italics, followed by the survey results. We also include interpretative and explanatory information.

A. Obtaining Shareholder Approval Is Often Difficult and Costly

1. Delays in Reaching Quorum and Resolving Voting Matters

Q1. Provide the number of related adjournments (if any) for each reported 1940 Act Majority Item.

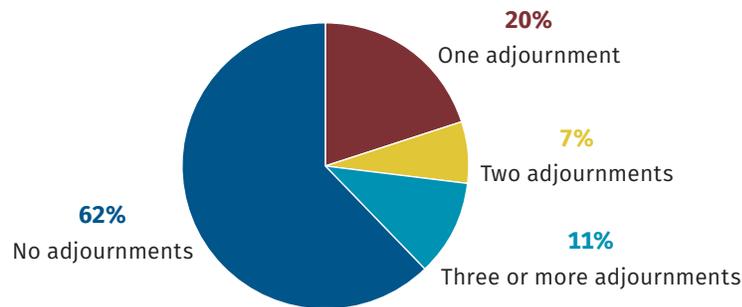
As indicated in Figure 1 below, a significant percentage—38 percent—of proposals required at least one adjournment, and some required multiple adjournments. When a shareholder meeting adjourns, the affected fund(s) must reconvene the meeting at a later date (in some cases, multiple times) to resolve the proxy matter.

Of course, adjournment statistics are only one measure of difficulty. They do not account for the costs of funds or advisers committing additional money and other resources to secure a timely quorum and *avoid* adjournments and the uncertainty that they bring. Nevertheless, these numbers suggest that despite such efforts, adjournments are common.

FIGURE 1

Thirty-Eight Percent of Proposals Required at Least One Adjournment to Reach Quorum

Percentage of proposals



Note: Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

2. Overall Cost Estimates

Q2. For each reported 1940 Act Majority Item, provide the total cost of the related proxy campaign.

Respondents provided cost estimates for 145 campaigns over the past seven years, with costs totaling over \$373 million.²¹

- » Twenty-two campaigns had costs greater than or equal to \$1 million.
- » Eight campaigns had costs greater than or equal to \$10 million.
- » Three campaigns had costs exceeding \$50 million.
- » The highest reported campaign cost was \$107 million.
- » Campaigns otherwise ranged in cost, with some totaling less than \$100,000.

The \$107 million figure is not the all-time high for a fund proxy campaign. As part of our outreach, another member informed us that the total cost of its 2009 proxy campaign (outside the period of our survey) was nearly \$136 million.

²¹ This \$373 million total understates overall industry proxy costs. See *supra*, Section III.

In speaking with members reporting lower-cost campaigns (which included larger and smaller fund complexes alike), certain commonalities emerged:

- » The campaigns were often limited in scope, (e.g., they may have included only a single item for a single fund); and/or
- » The funds had shareholder bases requiring little or no follow-up solicitation, because they had one or more of the following:
 - » Relatively large percentages of institutional investors, who are much more likely to vote;
 - » Relatively large percentages of shareholders that can, and do, “echo vote;”²²
 - » Greater knowledge of and visibility into the shareholder base, allowing more efficient direct communications; and/or
 - » Relatively concentrated shareholder bases (i.e., single shareholders holding large percentages of a fund’s shares), where the large shareholders vote.

Moreover, funds often know whether they have these factors in their favor, and they are much more likely to seek shareholder approval of items when their anticipated costs and difficulties are more reasonable.

We note that “cost” is a relative term—the size of a fund impacts how well it can bear costs of varying magnitudes. ICI’s Small Funds Committee members have been particularly engaged on these matters and vocal in their desire for reform.²³ Even costs that appear “low” in absolute terms can have an outsized effect on small funds and their shareholders.²⁴ Internal personnel at smaller complexes also are less able to absorb a campaign’s burdens. Finally, smaller funds may be subject to expense caps, meaning the advisers will absorb a greater percentage of the costs.

²² This is a common feature of insurance-dedicated funds and fund of funds arrangements. “Echo” (or “mirror”) voting occurs when a fund shareholder votes all of its shares in the same proportion (e.g., “for” and “against”) as the vote of some or all of the other shareholders.

²³ See, e.g., Letter from Neil J. Hennessy, Chairman, Chief Executive Officer, and Teresa M. Nilsen, President, Chief Operating Officer, Hennessy Advisors, Inc., to SEC Chairman Jay Clayton, dated September 6, 2018, available at www.sec.gov/comments/4-725/4725-4326425-173233.pdf; and Letter from Andy Martin, President, 7Twelve Advisors, LLC, to the SEC, dated June 28, 2019, available at www.sec.gov/comments/4-725/4725-5744107-186768.pdf.

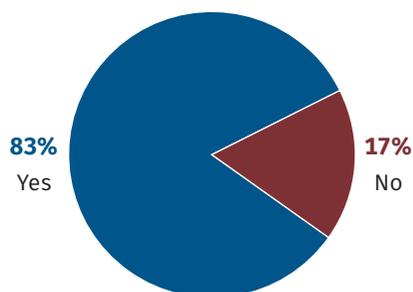
²⁴ See June Letter at 5-6.

Q3. Did the proxy campaigns for which you provided information require your firm to divert resources (personnel time or money) as part of the solicitation process to ensure a successful campaign?

FIGURE 2

Eighty-Three Percent of Respondents Diverted Resources to Support Proxy Campaigns

Percentage of complexes



Note: Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

Respondents also shared the following:

- » “The campaign required the firm to hire 5 full time employees dedicated to leading the proxy campaign and required collaboration from dozens of employees across 11 different teams.”
- » “The complex-wide proxy in 2018–2019 took approximately 10 months. It occupied a substantial portion of the time of several teams throughout the firm, including private wealth, legal, operations and transfer agency. It was an enormous undertaking.”
- » “A significant amount of resources is dedicated to the solicitation process for each proxy campaign. This involves coordination between Mutual Fund Services, Legal and the proxy solicitation vendor and results in associated costs in terms of both personnel time and proxy solicitation vendor fees. We also experience an increase in phone calls to the regular call service center during campaigns.”
- » “We require our Funds Management Team and Relationship Management teams to reach out to shareholders to ask if they could return a voted ballot for the proxy so we may reach quorum. Along with the solicitation agent’s calling campaign this was a significant amount of resources.”

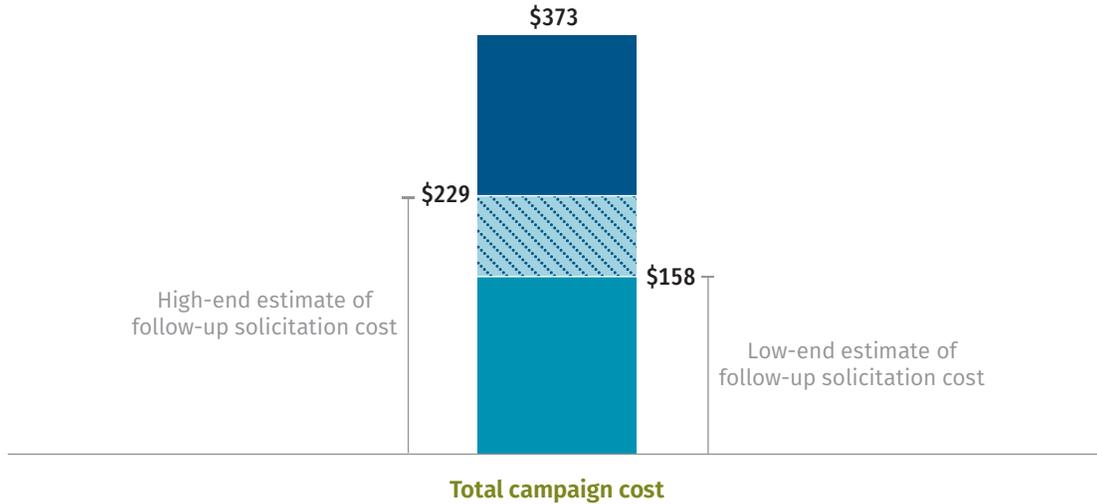
3. Follow-up Solicitation Cost Estimates

Q4. Estimate the percentage of the overall cost attributable to follow-up solicitation expenses (e.g., costs associated with follow-up mailings, emails, and phone calls).²⁵

FIGURE 3

Estimated Follow-Up Solicitation Costs as a Portion of Total Campaign Costs

Millions of dollars



Note: Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

Applying the follow-up solicitation cost estimates (in percentages) to each respondent's estimated campaign costs (in dollars), the overall high-end estimate of follow-up solicitation costs is \$229 million (or 61 percent of total campaign costs provided by respondents), and the low-end estimate is \$158 million (or 42 percent of total campaign costs provided by respondents).²⁶ Follow-up solicitation costs are one way to fairly assess some of the costs that funds incur when "chasing quorum" to satisfy the 1940 Act's approval standards. Thus, assuming there would be significantly less or no follow-up solicitation, these costs serve as a useful measure of the savings that ICI's Supermajority Recommendation could generate.

²⁵ Respondents provided estimates in ranges of 20 percent increments, *i.e.*, "0 to 20 percent," "21 to 40 percent," "41 to 60 percent," "61 to 80 percent," and "81 to 100 percent."

²⁶ To illustrate, if a respondent estimated an overall campaign cost of \$500,000 with estimated follow-up solicitation costs between 41 and 60 percent, its estimated follow-up solicitation costs in dollars would range from \$205,000 to \$300,000. We then summed these low and high estimates for all campaigns.

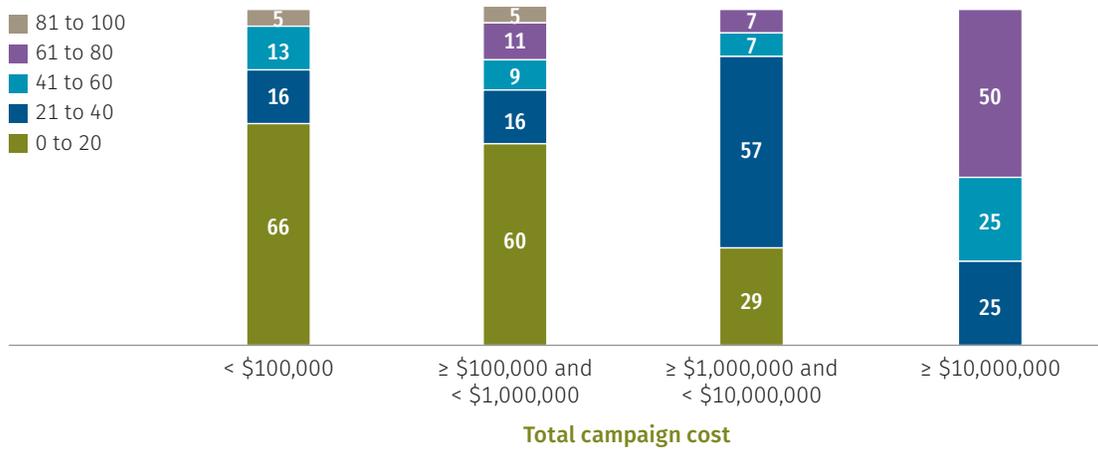
Generally speaking, these follow-up solicitation cost estimates differ depending on the overall cost (in dollars) of the campaigns, with more costly campaigns having higher-percentage cost estimates. This makes sense—campaigns often become costly *precisely because* of the effort to contact, and convince, a larger number of shareholders to vote. Figure 4 below demonstrates how these estimates varied based on overall campaign costs.

FIGURE 4

Higher Cost Campaigns Tend to Spend More Money on Follow-Up Solicitation

Percentage of campaigns

Share of campaign cost associated with follow-up solicitation



Note: As noted on page 11, some proxy campaigns are relatively low-cost because they may be of limited scope and/or the funds' shareholder bases may have features that significantly reduce the need for follow-up solicitation. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

4. Qualitative Assessment of ICI’s Supermajority Recommendation

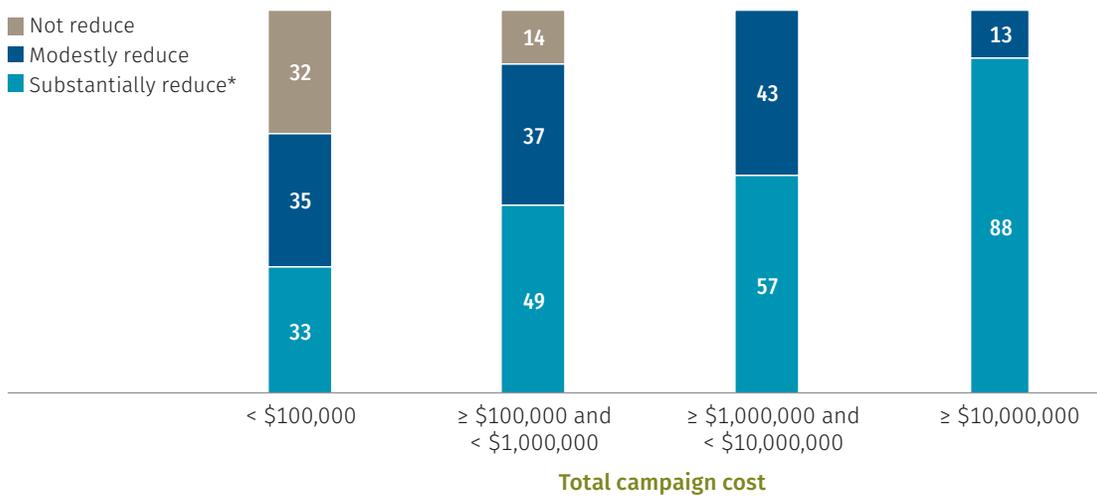
Q5. Assume for your reported 1940 Act Majority Items that your funds instead could have relied on the ICI’s Supermajority Recommendation, and assess the impact this would have had on costs and challenges associated with the campaigns.²⁷

In response to this question, we once again saw a notable correlation between the overall costs of the campaigns and the respondents’ assessments of the anticipated effects of ICI’s Supermajority Recommendation. Even for most of the less costly campaigns, the Recommendation would have allowed funds to reduce or substantially reduce total campaign costs.

FIGURE 5

Survey Participants with Costlier Campaigns Reported that ICI’s Supermajority Recommendation Will Substantially Reduce Their Total Proxy Campaign Costs

Percentage of campaigns



*Substantially reduce includes respondents that answered “substantially reduce” or “significantly reduce.”

Note: As noted on page 11, some proxy campaigns are relatively low-cost because they may be of limited scope and/or the funds’ shareholder bases may have features that significantly reduce the need for follow-up solicitation.

²⁷ The four available choices were: “It would not have reduced the campaign’s costs and challenges,” or “It would have [significantly/substantially/modestly] reduced the campaign’s costs and challenges.”

B. The Proxy System’s High Costs and Challenges Are Disproportionately Affecting Decisions Related to Fund Policies, Governance, and Operations

Not all of the current proxy system’s costs are quantifiable in dollars. In some cases, the anticipated costs of the proxy process deter or delay funds from taking certain actions.

1. Effects on Fund Policies

The 1940 Act and rules thereunder grant funds broad flexibility to establish policies and change them without shareholder approval, provided they are not “fundamental.” Even policies integral to a fund’s investment strategies and risk profile—such as those requiring applicable funds to invest at least 80 percent of their assets in the types of investment suggested by their names—need not be fundamental.²⁸

But with limited staff-provided exceptions,²⁹ changes to all fundamental policies require shareholder approval. The 1940 Act requires funds to maintain certain policies as fundamental.³⁰ Funds also voluntarily have deemed other policies to be fundamental, sometimes in response to SEC staff comments on registration statements.³¹ As indicated in Section IV.C below, a substantial percentage of 1940 Act Majority Items are proposals to change fundamental policies, suggesting that they are not uncommon. In some cases, however, funds continue to operate under certain fundamental policies simply because the anticipated costs and challenges to change them are high. For instance, some funds still have fundamental policies established in response to comments from state securities regulators, which they received prior to enactment of the National Securities Markets Improvement Act of 1996.

²⁸ See Rule 35d-1 under the 1940 Act. Under Rule 35d-1, if a fund wishes to change the investment policy related to its name (and the policy is not fundamental), the fund must provide its shareholders with at least 60 days prior notice of the change. Rule 35d-1 as proposed would have required these “name-related” policies to be fundamental. Commenters argued—and the SEC was persuaded—that this requirement would have been “too burdensome for investment companies, constraining their ability to respond efficiently to market events or to new regulatory requirements...” See *Investment Company Names*, SEC Release No. IC-24828 (Jan. 17, 2001), available at www.sec.gov/rules/final/ic-24828.htm.

²⁹ See, e.g., *Stradley Ronon Stevens & Young, LLP*, SEC Staff No-Action Letter (June 24, 2019), available at www.sec.gov/investment/stradley-062419 (permitting index-based funds to exceed the limits of a “diversified company” (as defined in the 1940 Act) in certain circumstances without shareholder approval).

³⁰ See Section 8(b) of the 1940 Act and *supra*, note 12.

³¹ Cf. *Protecting Investors: A Half Century of Investment Company Regulation*, SEC Division of Investment Management, May 2002, at 278 (recommending that Sections 8(b) and 13(a) of the 1940 Act be amended to classify as fundamental a fund’s investment objective), available at www.sec.gov/divisions/investment/guidance/icreg50-92.pdf.

In many cases, requiring shareholder approval with the attendant proxy costs to make limited changes to a fundamental policy seems unnecessarily restrictive. For instance:

- » One member sought to implement an interfund lending program for its funds. But first, some funds needed shareholder approval to change their fundamental policies on borrowing and lending, which were too restrictive to accommodate such a program (e.g., under their old policies, funds could borrow only from banks). That proxy campaign's cost was \$10 million.
- » Another member sought to change a fund's name and its related "names rule" policy to reflect the fund's reduced focus on Middle Eastern and North African countries and greater emphasis on mainland Europe. These actions did not require shareholder approval. But because the fund's investment objective was "fundamental" and it referred to investments in "the Mediterranean region," the fund needed shareholder approval. As a result, the fund incurred proxy costs, even though the rule directly governing such changes (Rule 35d-1) did not require shareholder approval.
- » One member had several funds with commodities-related fundamental policies that limited the types of derivatives that they could use. The funds sought to broaden these policies to permit investments in any commodity-related investments permitted by law. (The proxy statement indicated that no immediate changes to the funds' management or risk profiles were anticipated.) Shareholders for some funds approved the changes at the first shareholder meeting. Shareholders for other funds within the complex approved the changes as part of a second campaign. And shareholders for two remaining funds still have not approved the changes, leaving the fund manager with disparate policies across the funds.

Q6. Assume that shareholder approval was not required to change fundamental policies, and instead such changes required only board approval and advance notice to shareholders. Would you consider changing any of your funds' existing fundamental policies?

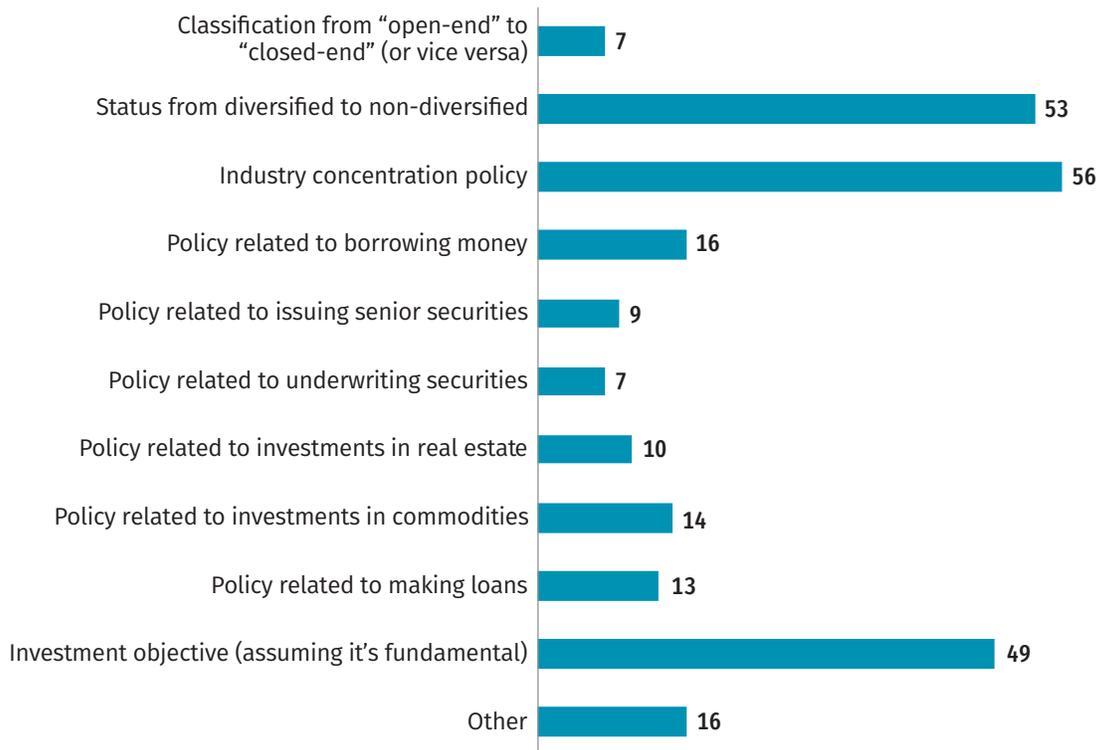
Seventy-seven percent responded "Yes."

Q7. To those responding “Yes” to the question above, which policies would you consider changing for at least 1 of your funds?

FIGURE 6

Most Respondents Would Considering Changing a Fundamental Policy for at Least One Fund with Board Approval and Advance Shareholder Notice

Percentage of respondents stating “yes”



Note: Respondents could choose multiple categories of fundamental policy. A respondent’s choice of a particular category does not mean that it would change the policy for *all* of its funds, but only for at least one of its funds. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

2. Effects on Fund Governance

*Q8. Has the fund proxy process (including its costs and challenges) impeded your fund complex's willingness to add new board members?*³²

Forty percent of respondents answered “Yes,” and shared the following:

- » “Under current rules, a complex wide meeting to refresh our board slates costs in excess of \$45 million, even with the use of efficiencies such as Notice and Access. Given the Investment Company Act requirements/limitations on adding new board members without a shareholder vote, our boards engage in a continuous long-term planning exercise to ensure that the funds have a strong/adequate board membership while minimizing the number of shareholder meetings at the same time. Among other considerations, this framework does result in limiting the candidate pool to individuals with longer service runways, requires the boards to be of a size to be able to absorb a certain number of retirements, and ultimately is very costly.”
- » “We have independent trustees who are approaching retirement age. The cost of a proxy campaign has been a factor in when to replace them.”
- » “Although in many cases we are able to onboard new members to our advisory board, proxy considerations have sometimes significantly delayed the time between when a new member is identified and when they are formally elected.”
- » “We would eventually like to add multiple new directors, but we want to add them all at the same time so we only have to do one proxy solicitation. This means that potential candidates identified earlier may be put on hold for a substantial length of time until all candidates are identified.”
- » “Our complex has multiple boards and there have been times where we have considered consolidating or restructuring boards but the proxy process has been a factor in our decisions not to make changes.”

As illustrated above, fund complexes have thoughtful discussions about board composition and succession planning around director retirements. Fund boards are mindful of the timing of director retirements and spend considerable time recruiting and onboarding new members. The costs associated with a proxy vote are an important factor affecting the timing and other aspects of board refreshment.

On director election votes, we offer two additional observations. First, as noted above, funds rely on broker discretionary voting to achieve a quorum and elect directors.³³ Significant changes to broker voting practices industrywide would make director elections much more difficult, costly, and time-consuming.

³² See *supra*, note 5. This is not a 1940 Act Majority Item.

³³ See *supra*, notes 14 through 16, and accompanying text.

Second, even a relatively smooth director election campaign can be very expensive. One member stated that its 2018 proxy campaign to elect directors (which included no 1940 Act Majority Items and therefore was not captured in our survey data) cost nearly \$50 million, due to the number of fund shareholders and the attendant costs of preparing, printing, and mailing even one set of proxy materials to each. Again, ICI's recommendations on disclosure in the June Letter (*i.e.*, permitting linking to lengthy required disclosures) and processing fees would significantly reduce these costs.

3. Effects on Fund Operations

Q9. Has the fund proxy process (including its costs and challenges) led you to liquidate any of your funds (e.g., a fund was liquidated rather than merged with another because of the anticipated costs and challenges of obtaining shareholder approval)?

Thirty-six percent of respondents answered "Yes," and shared the following:

- » "We chose to liquidate rather than merge a fund because the cost and duration of a proxy campaign can offset the benefits of a merger over a liquidation."
- » "We have recommended liquidating funds (particularly funds with lower asset levels) rather than merging them when the costs of shareholder approval of a merger were deemed to outweigh the benefits."
- » "High proxy cost/low possibility of reaching quorum. Better to skip those costs (and client service headaches from solicitation) and just liquidate."

In many cases, a liquidation is the best option for a fund and its shareholders. While potentially high proxy costs are by no means the only factor that may affect a liquidation decision, it is a factor. If proxy costs were reduced, it could make alternatives to liquidations more attractive, including certain reorganizations that could be less disruptive to shareholders' portfolios and investment strategies and more tax-efficient (for those investing in taxable accounts).³⁴

³⁴ Some liquidations require shareholder approval, depending on state law and/or the terms of a fund's organizational documents. And some fund reorganizations do not require shareholder approval. *See supra*, note 4.

Q10. Has the fund proxy process (including its costs and challenges) impeded your fund complex from taking any other actions that you believe would benefit your fund(s) and shareholders?

Fifty percent of respondents answered “Yes,” and shared the following:

- » “[It] [d]eterred us from potential fund mergers that would have helped to lower expenses and achieve better economies of scale.”
- » “We are not relying on the new manager of managers order which permits the hiring of partially-owned affiliates because it requires shareholder approval, which we believe is too expensive.”
- » “Certain funds have antiquated charters that impose limitations significantly beyond those imposed by the 1940 Act and current state law. We would be interested in amending certain of these charters but for the burden of the proxy process. The proxy process is not only expensive and time consuming but it is very hard to obtain participation from shareholders and solicitation efforts are generally not well-received by shareholders or advisors.”
- » “[I]n general, it causes [a] lack of desire to even discuss doing things like cleaning up/conforming policies or dec[laration] of trust provisions.”
- » “In some cases, we have decided against pursuing changes that would require a proxy solicitation, because we felt that the combination of campaign expenses, drain on internal resources and disruption to clients (repeated solicitation calls and mailings required to get the vote) outweighed the potential benefits of the change.”

C. Voting Shareholders Strongly Support 1940 Act Majority Items

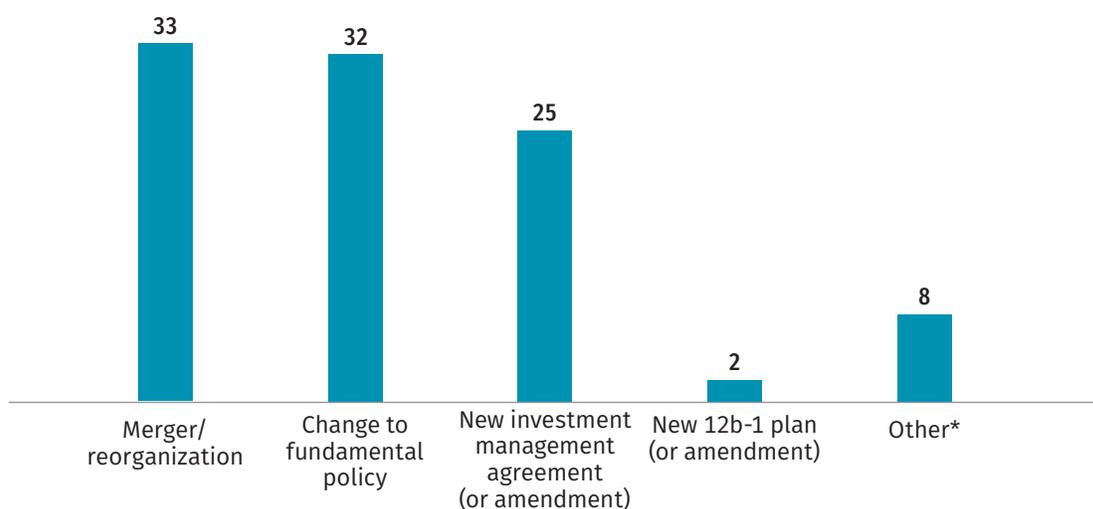
Q11. For any completed proxy campaigns within the last seven years that had at least one 1940 Act Majority Item, please provide information about the type of proposal.³⁵

On proposal type, respondents classified the overwhelming majority (90 percent) of their Items as proposed mergers or reorganizations, changes to fundamental policies, and/or new investment advisory agreements (or amendments thereto), as indicated in Figure 7 below.

FIGURE 7

Proposals by Type

Percentage of proposals



* Most items that respondents categorized as “Other” related to approvals required under the SEC’s “manager of managers” exemptive relief, which permits a fund complex with an order to enter into and materially amend sub-advisory agreements without shareholder approval, subject to numerous conditions (e.g., before a sub-advised fund may rely on the order, fund shareholders must approve it under the 1940 Act Majority standard).

Note: We collected data on 208 1940 Act Majority Items on which shareholders have voted over the past seven years. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

³⁵ We specifically asked respondents to exclude items *not* requiring a 1940 Act Majority, such as director elections or auditor ratifications; provide information for no more than five such items (the five most recent); and for any general campaign affecting multiple funds in a similar way (e.g., multiple fund reorganizations occurring at the same time), list it as a single item and aggregate the information as appropriate (e.g., vote counts).

Q12. Over the past ten years, has your fund complex sought shareholder approval to raise fees for any fund (e.g., by amending an investment advisory agreement or Rule 12b-1 plan)?

Eighty-seven percent of respondents answered “No,”³⁶ indicating that proxy proposals seeking fee increases are not a meaningful percentage of funds’ overall proxy activity.³⁷

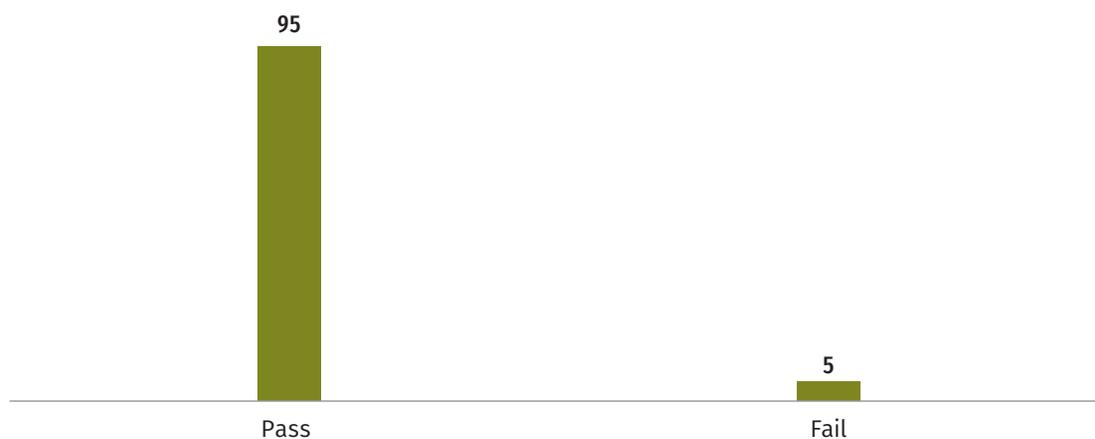
Q13. For any completed proxy campaigns within the last seven years that had at least one proposal requiring a 1940 Act Majority, please provide the ultimate outcome (pass or fail).

Despite proxy campaigns’ inherent challenges and high costs, fund shareholders approved an overwhelming percentage—95 percent—of the 1940 Act Majority Items for which respondents provided data.

FIGURE 8

The Vast Majority of 1940 Act Majority Proposals Passed

Percentage of proposals identified by survey participants



Note: One survey participant did not provide vote outcomes on two proposals. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

³⁶ However, two respondents answering “Yes” indicated that these proposals did *not* increase the funds’ overall expense ratios, and another noted that its proposal failed, for lack of shareholder support.

³⁷ If ICI’s Supermajority Recommendation were adopted, we have no reason to believe this dynamic would change, given the checks built in to it (e.g., at least 75 percent affirmative support from shareholders and unanimous board approval) and the highly competitive market in which fund fees and expenses continue to fall.

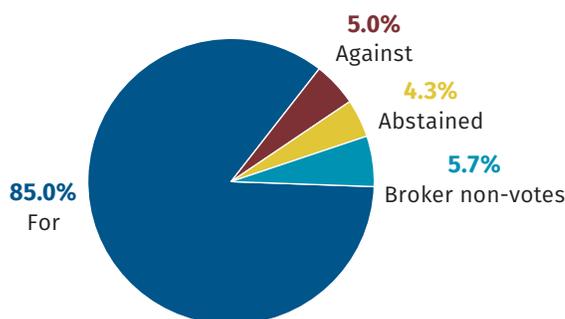
Q14. For each reported 1940 Act Majority Item, provide the applicable vote totals (i.e., total votes “for” and “against,” abstentions, and broker non-votes).

Not only do 1940 Act Majority Items overwhelmingly pass, but *voting* shareholders favor them by wide margins. Based on our results, the (mean) averages of shares present at these shareholder meetings in each of the following four categories—i.e., votes cast “for” and “against” a proposal, abstentions, and broker non-votes³⁸—consisted overwhelmingly of votes cast “for,” at 85 percent.

FIGURE 9

Voting Shareholders Strongly Vote “For” 1940 Act Majority Items

Percentage of shares present, averaged across survey participants



Note: See Appendix A for a description of broker non-votes and how they affect 1940 Act Majority votes. Broker non-votes commonly are submitted in situations where a proxy campaign includes at least one 1940 Act Majority Item and at least one proposal for which a broker-dealer votes without instructions from its customer (e.g., director elections). A 1940 Act Majority Item may not have broker non-votes if it was part of a campaign with no discretionary voting items. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

Excluding abstentions and broker non-votes, the average percentage of votes cast “for” these Items jumps to 94 percent.

These findings confirm that the judgments of fund shareholders are strongly aligned with those of fund management and fund boards on these proxy matters. This is not surprising. Given the costs and challenges of the proxy process, fund management will not propose—and fund boards will not approve—a 1940 Act Majority Item unless they have a high degree of conviction that shareholders would support it.

Yet, these findings—showing high shareholder support—starkly highlight why it is both necessary and appropriate for the SEC to reform the proxy system to reduce its current costs and challenges. Examining proxy cost information together with shareholder voting data demonstrates that the current proxy system is failing to facilitate a cost-effective governance process.

³⁸ See Appendix A for a discussion of these four categories and how they affect votes on 1940 Act Majority Items.

D. Most Funds Would Benefit from ICI's Supermajority Recommendation

If the SEC adopted our Supermajority Recommendation, it would not override other applicable legal and regulatory requirements (e.g., state law or existing requirements in a fund's organizational documents). Rather, it would provide an alternate approval method for a 1940 Act Majority Item.

We reviewed relevant state laws to determine their consistency with our Supermajority Recommendation. Based on ICI data as of September 30, 2019, 94 percent of funds (representing 95 percent of fund assets) are organized and operate as Delaware statutory trusts, Massachusetts business trusts, or Maryland corporations.³⁹ The Recommendation would in fact be consistent with these state law requirements, meaning that virtually the entire fund industry could conceivably benefit.⁴⁰

Appendix B includes a chart summarizing the relevant provisions for these three states. As the chart indicates, an SEC rule permitting funds to achieve a majority vote with a minimum quorum of greater than 33⅓ percent would be consistent with the applicable state requirements.⁴¹ Indeed, a significant aspect of this Recommendation is that no other authorities (e.g., state legislatures or exchanges) must act to accommodate the change.

Q15. In your funds' organizational documents, what is the default minimum quorum requirement for shareholder meetings (i.e., the quorum that would generally apply to a shareholder meeting, barring applicability of another more demanding standard, such as the current 1940 Act Majority standard)?

We asked this question to complement our state law analysis. Even if domiciled in a state with shareholder meeting provisions that accommodate our Supermajority Recommendation, a fund's organizational documents may impose a higher standard than either state law or the Recommendation.

³⁹ These numbers were calculated based on the 12,153 funds that report this information to ICI. Based on this fund universe, 45 percent of these funds are Delaware statutory trusts, 35 percent are Massachusetts business trusts, and 14 percent are Maryland corporations; the remaining funds are other types of business entities in these three states or are domiciled in all other states. Measuring based on total fund assets, 54 percent of these fund assets are held in Delaware statutory trusts, 30 percent are held in Massachusetts business trusts, and 11 percent are held in Maryland corporations; the remaining fund assets are held in other types of business entities in these three states or in entities domiciled in all other states.

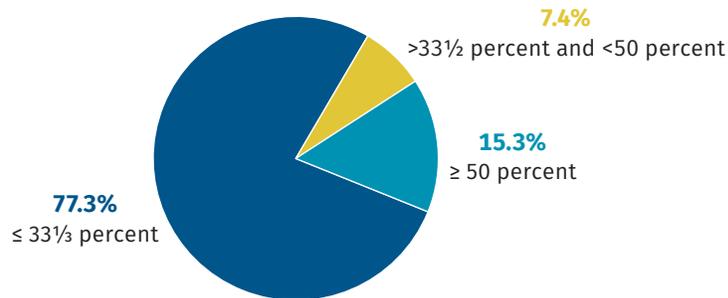
⁴⁰ Funds sometimes redomicile for legal, operational, or business reasons. If a fund were domiciled in a state with a higher minimum quorum requirement for shareholder meetings, it could redomicile in a state with requirements compatible with any new requirements, if it thought the benefits of doing so would outweigh the costs.

⁴¹ We view this 33⅓ percent figure as a *de facto* floor, at least presently. We would support the SEC choosing a lower number, but it would not yield much of an immediate marginal benefit (compared to 33⅓ percent), barring further state action (and in many cases, further amendments to funds' organizational documents).

FIGURE 10

Most Funds' Existing Minimum Quorum Requirements Permit Use of ICI's Supermajority Recommendation

Percentage of funds



Note: Survey respondents provided quorum-related information for over 6,700 funds. Data are based on survey responses representing 76 percent of US registered fund assets as of June 30, 2019.

Based on the current terms of their organizational documents, nearly 85 percent of funds would benefit from ICI's Supermajority Recommendation.⁴²

Finally, we expect the percentage of funds with minimum quorums of approximately $33\frac{1}{3}$ percent to increase going forward. Two respondents with minimums that vary by fund explained that their recently launched funds have the lower quorum requirement. Funds' difficulties in obtaining shareholder approvals no doubt at least partially explains this trend.

E. Additional Cost Savings from ICI's Other Recommendations

Notably, the Fall 2019 survey's cost questions related directly to ICI's Supermajority Recommendation. In our June Letter, ICI also recommended that the SEC:

- » Permit funds greater freedom to link in proxy statements to more extensive information (e.g., information about the funds' beneficial owners);
- » Reform processing fees; and
- » Create alternative means for funds to change fundamental policies or hire sub-advisers without shareholder approval.

These additional recommendations would reduce costs further. For example, the disclosure linking recommendation would reduce printing and mailing costs for most proxy campaigns, with the extent of savings directly related to the number of (i) funds included in a multi-fund proxy statement, and (ii) shareholders receiving full proxy

⁴² Of course, those funds that have a higher standard (e.g., a minimum quorum requirement of greater than 50 percent) could consider amending their organizational documents to benefit from the Recommendation's flexibility.

materials. In each case, the larger the number, the greater the savings. In some cases, the potential page count reductions would be substantial:

- » One member's 2017 combined proxy statement totaled 237 pages, over three-quarters (185 pages) of which consisted of beneficial owner information.
- » Another member's 2017 combined proxy statement totaled 162 pages, almost half (77 pages) of which consisted of beneficial owner information.
- » A third member estimates that lists of beneficial owners have comprised from 30 to 47 percent of the total page counts of its joint fund proxy statements.⁴³

Funds' processing and distribution costs are another important sub-set of proxy costs where the SEC could achieve significant savings for funds. Combining the common-sense disclosure reforms described above with ICI's proxy processing fee recommendations⁴⁴ would dramatically reduce costs for *all* fund proxies, not just multi-fund proxies or those containing 1940 Act Majority Items. For example:

- » One member indicated that in its experience with routine proxies, "the initial print and mail costs account for approximately 30-35% of the overall proxy cost with substantially all of the remaining cost attributable to fees charged by the proxy service firm."⁴⁵
- » Another member reported that of the millions of dollars spent on its most recent proxy campaign, more than half was attributable to the fees paid to the primary fulfillment vendor that had been engaged by intermediaries to deliver proxy materials to fund shareholders investing through those intermediaries.

Finally, permitting funds to use alternative methods for certain 1940 Act Majority Items (*e.g.*, board approval and advance shareholder notice to change fundamental policies) in place of a proxy campaign would produce savings far greater than our Supermajority Recommendation for those affected Items.⁴⁶ Permitting fundamental policy changes in this way would reduce their costs to a small fraction of those incurred in a proxy campaign—costs essentially would be limited to preparing and mailing the shareholder notice.

* * * * *

⁴³ See Letter from Barbara Novick, Vice Chairman, and Janey Ahn, Managing Director, Legal & Compliance, BlackRock, to Vanessa Countryman, Secretary, SEC, dated November 12, 2019 ("BlackRock Letter"), at 3, available at www.sec.gov/comments/4-725/4725-6419614-198529.pdf.

⁴⁴ See Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC (Oct. 31, 2018), available at www.sec.gov/comments/s7-13-18/s71318-4594882-176335.pdf.

⁴⁵ BlackRock Letter at 3.

⁴⁶ See Section IV.B.1, *supra*.

Appendix A: ICI’s Supermajority Recommendation Explained

We recommend that the SEC use its exemptive authority to create the following new third way—to complement the existing two statutory ways—for a fund to achieve a 1940 Act Majority for 1940 Act Majority Items:

A fund will be deemed to have received a “vote of a majority of the outstanding voting securities of a company” with “75 percent or more of those shares affirmatively voting at such meeting, if the holders of more than one-third of the outstanding voting securities of such company are present or represented by proxy.”

As an additional protection, we recommend coupling this new method with a requirement that a fund’s board unanimously approve the proposed action presented for shareholder approval.

A shareholder may vote “for” a proposal, “against” it, or affirmatively “abstain” on a proxy card. Also, these 1940 Act Majority Items could include “broker non-votes,” (*i.e.*, proxy cards submitted by broker-dealers *without* voting instructions for a 1940 Act Majority Item). As the name suggests, these broker non-votes are *not* votes registered by the fund’s beneficial owner or the broker-dealer (*i.e.*, the record owner of the fund shares). Rather, they commonly are submitted in situations where a fund proxy campaign includes at least one 1940 Act Majority Item and at least one proposal for which a broker-dealer lawfully votes without instructions from its customer (*e.g.*, director elections or auditor ratifications).⁴⁷

In such a case, assuming a beneficial owner expresses no voting preference on any item, this beneficial owner’s multi-item proxy card could contain both voting instructions furnished by the broker-dealer for the non-1940 Act Majority Item(s) and no instructions of any kind (*i.e.*, a “broker non-vote”) for the 1940 Act Majority Item(s).

Currently, shares present at a shareholder meeting falling in any of the four categories—votes cast “for” and “against,” abstentions, and broker non-votes—affect outcomes of 1940 Act Majority votes in two ways. First, shares in any of the four categories count towards quorum. This quorum calculation method shown directly below is well-established and follows directly from the statutory language (all of these shares are “present or represented by proxy” at the meeting), and ICI proposes no change to it:

$$\frac{\text{For+Against+Abstain+Broker Non-Votes}}{\text{Total Outstanding Voting Fund Shares}}$$

⁴⁷ NYSE Rule 452 permits NYSE members to vote customers’ shares without customer instruction for “routine” matters, which for funds include director elections and auditor ratifications. NYSE members do not have discretion to vote on 1940 Act Majority Items without customer instruction.

Second, shares in any of the four categories also count in determining whether the requisite 67 percent approval threshold is met because the 1940 Act requires that a fund obtain “67 per centum or more of the voting securities *present at such meeting...*” (emphasis added). Only votes “for” a proposal count towards approval (*i.e.*, appear in the numerator). Shares in each of the four categories must be included as present (*i.e.*, appear in the denominator) for this approval calculation, as follows:

$$\frac{\text{For}}{\text{For}+\text{Against}+\text{Abstain}+\text{Broker Non-Votes}}$$

Including abstentions and broker non-votes in this way hinders approval of 1940 Act Majority Items, with shares in these categories effectively acting as votes *against* the proposal.

To illustrate how this currently works, suppose that:

- » A fund has 100 shareholders, each owning 1 fund share; and
- » in response to a 1940 Act Majority Item:
 - » 33 shareholders affirmatively voted for it;
 - » four affirmatively voted against it;
 - » three abstained;
 - » broker-dealers for 11 shareholders submitted 11 non-votes; and
 - » the remaining 49 shareholders (and their intermediaries, if applicable) did not respond in any way.

This proposal would meet the quorum requirement (51/100) but *fail* because it garnered an approval percentage of only 64.7 percent (33/51), short of the necessary 67 percent.

But neither state law nor the federal securities law requires a single, uniform manner of counting shareholder votes. For example, the “resubmissions” exclusion in the shareholder proposal rule currently counts “votes cast” to determine the level of shareholder support, a standard that excludes both abstentions and broker non-votes.⁴⁸

Also, Exchange Act Rule 16b-3(d) contains a shareholder approval provision for executive compensation plans, and it specifically requires “affirmative votes of the holders of a majority of the securities of the issuer present, or represented, *and entitled to vote at a meeting...*” (emphasis added) In connection with this voting item, the SEC staff has stated that “broker non-votes should not be considered shares entitled to vote because the

⁴⁸ Exchange Act Rule 14a-8(i)(12). See also *Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8*, SEC Release No. 34-87458 (Nov. 5, 2019)(the “Proposing Release”), available at www.sec.gov/rules/proposed/2019/34-87458.pdf. The Commission states in the Proposing Release that “[s]ince 1948, the Commission has not required a company to include a proposal in its proxy statement ‘if substantially the same proposal was submitted to the security holders for action at the last annual meeting of security holders ... and received less than three percent of the total number of votes cast in regard to the proposal.’” (emphasis added) Proposing Release at 41. The proposal likewise only would count votes cast for and against a shareholder proposal. Abstentions and broker non-votes would not be included in the calculation. *Id.* at n.116. The Commission neither explains its rationale for this “votes cast” standard, nor does it propose to change it.

broker and proxy holder do not have the authority to vote the shares with regard to the plan. Accordingly, broker non-votes would not affect the outcome of a vote on a Rule 16b-3 proposal.”⁴⁹

Relevant state codes in Delaware, Massachusetts, and Maryland are silent regarding how broker non-votes must be treated for shareholder approval items. Their shareholder approval default provisions (if adopted by a fund) allow for the possibility that broker non-votes would *not* be counted for approvals.⁵⁰ Although the Delaware code does not address broker non-votes, the Delaware Supreme Court has, stating that:

- » “[s]tockholders who are present at a meeting are properly counted in the determination of a quorum even though the shares are not voted;”
- » “[w]here a proposal is nondiscretionary and the broker or fiduciary record holder receives no instructions from the beneficial owner, voting power on that proposal has been withheld;”
- » broker non-votes in this instance were not “voting power present” (the operative language in the company’s organizational documents) but *were* present for purposes of the quorum requirement; and
- » “Section 216 of the Delaware General Corporation Law expressly contemplates that the number of shares ‘counted’ for quorum purposes need not necessarily be the same as the number of shares required to be ‘present’ for voting purposes.”⁵¹

Under state law generally, one looks to any requirement in the code (if applicable) and also to the controlling language in the fund’s organizational documents. For instance, Maryland corporate law provides that unless the statute or the company’s charter provides otherwise, the majority of all *votes cast* at a meeting at which a quorum is present is sufficient to approve any matter.⁵² Assuming a fund adopted this “votes cast” standard verbatim in its organizational documents, a broker non-vote would not be a “vote cast” and therefore would not be included for approval purposes (*i.e.*, it would be excluded from the denominator).

In sum, precedent exists under federal securities law and state law for the SEC to exclude broker non-votes from approval calculations in any future proxy-related rules or guidance that it may adopt.

If the SEC were to adopt a rule in accordance with ICI’s Supermajority Recommendation, the best approach would be to exclude broker non-votes from the approval calculation (this follows from our proposed “shares affirmatively voting” language). ICI’s approach is appropriate because doing otherwise (as the 1940 Act currently does) effectively equates

⁴⁹ *American Bar Association*, SEC Staff No-Action Letter, 1993 SEC No-Act. LEXIS 782 (June 24, 1993).

⁵⁰ *See generally Voting Standards Are Not that Standard*, Harvard Law School Forum on Corporate Governance and Financial Regulation, posted by Daniel E. Wolf and Michael P. Brueck (Oct. 20, 2016), available at <https://corpgov.law.harvard.edu/2016/10/20/voting-standards-are-not-that-standard/>.

⁵¹ *Berlin v. Emerald Partners*, 552 A.2d 482 (Del. 1989).

⁵² MD. Code § 2-506.

shareholder *inaction* on a 1940 Act Majority Item with *opposition* to it, and thus does not accurately reflect the underlying sentiment of shareholders.⁵³ ICI therefore recommends the following approval calculation standard:

$$\frac{\text{For}}{\text{For}+\text{Against}+\text{Abstain}}$$

To illustrate how ICI's Supermajority Recommendation would work in practice, suppose that:

- » A fund has 100 shareholders, each owning 1 fund share; and
- » in response to a 1940 Act Majority Item:
 - » 28 shareholders affirmatively voted for it;
 - » two affirmatively voted against it;
 - » one abstained;
 - » broker-dealers for four shareholders submitted non-votes; and
 - » the remaining 65 shareholders (and their intermediaries, if applicable) did not respond in any way.

This proposal would *pass* because:

- » affirmative votes cast (for and against, and the sole abstention) and the broker non-votes would count towards quorum, so at 35 percent (35/100) the fund would exceed the 33⅓ percent quorum requirement; and
- » the fund receives 90.3 percent support (28/31), exceeding the 75 percent affirmative vote requirement.

This would permit funds to more practically obtain shareholder approval for matters that both the board and an overwhelming percentage of voting shareholders approved. Indeed, our Recommendation would require funds to achieve a *higher* percentage of shareholder votes actually cast than the statute's provisions (75 percent or more, compared to 67 or more or more than 50 percent, depending on the statutory prong).⁵⁴ Of course, such a rule would not override other applicable legal and regulatory requirements (e.g., state law or existing requirements in a fund's organizational documents).⁵⁵ Rather, it would provide a measure of relief in those instances where the 1940 Act unjustifiably impedes funds' ability to seek and obtain shareholder approval in a reasonable and cost-effective way.

⁵³ ICI's Recommendation implicitly distinguishes abstentions (which could count and effectively act as votes against an item) from broker non-votes (which would not). Unlike a broker non-vote, a shareholder who submits a proxy card "abstaining" on an item has at least taken some affirmative action that is not in support of that item.

⁵⁴ We would not object if the SEC instead deferred to state law and funds' organizational documents in lieu of setting a minimum affirmative vote threshold in any rule or guidance.

⁵⁵ For instance, if applicable state law or a fund's organizational documents set a higher quorum requirement, that higher requirement would continue to control.

Appendix B: Relevant Delaware, Massachusetts, and Maryland Business Entity Provisions

	DE Statutory Trusts and Corporations	MA Business Trusts and Corporations	MD Corporations
Applicable Quorum Requirement for Shareholder Meetings	<p>Delaware <u>statutory trust</u> law merely provides that the governing instrument may contain any provision, if and to the extent that voting rights are granted under the governing instrument, setting forth quorum requirements or any other matter with respect to the exercise of the right to vote (Del. Code Title 12 § 3806(b)(5)).</p> <p>Under Delaware <u>general corporate</u> law, quorum may not be less than 1/3 of shares entitled to vote at the meeting (Del. Code Title 8 § 216). Common practice is for Delaware <u>statutory trusts</u> to follow this provision.</p>	<p>The Massachusetts <u>business trust</u> statute is silent regarding shareholder meeting requirements (Mass. Gen. Laws Ch, 182).</p> <p>Massachusetts <u>general corporate</u> law permits organizational documents to raise or lower the default quorum requirement (“majority of the votes entitled to be cast on the matter”) (Mass. Gen. Laws Ch. 156D §§ 7.25, 7.27(a), 10.21(a)).</p>	<p>Maryland corporate law permits 1940 Act-registered open-end funds’ bylaws to lower the default quorum requirement (“majority of all votes entitled to be cast”) to not less than 1/3 of votes entitled to be cast (MD. Code § 2-506).</p>
Applicable Shareholder Approval Requirement	<p>Delaware <u>statutory trust</u> law merely provides that the governing instrument may grant to (or withhold from) all or certain trustees or beneficial owners, or a specified class, group or series of trustees or beneficial owners, the right to vote, on any matter. If and to the extent voting rights are granted, the governing instrument may set forth any provision with respect to the exercise of such voting rights (Del. Code Title 12 §§ 3806(4), 3806(5)).</p> <p>Under Delaware <u>general corporate</u> law, in all matters other than the election of directors, the affirmative vote of the majority of shares present in person or represented by proxy at the meeting and entitled to vote on the subject matter shall be the act of the stockholders (Del. Code Title 8 § 216(2)). For voting requirements not dictated by the 1940 Act, common practice is for Delaware <u>statutory trusts</u> to follow this provision.</p>	<p>The Massachusetts <u>business trust</u> statute is silent on this matter (Mass. Gen. Laws Ch, 182).</p> <p>Massachusetts <u>general corporate</u> law provides that if quorum exists, favorable action on a matter (other than director elections) is taken if the votes cast within the group favoring the action exceed the votes cast opposing the action, unless the organizational documents or statute require a greater number of affirmative votes (Mass. Gen. Laws Ch. 156D §7.25(c)). Unless otherwise provided in the organizational documents, directors are elected by a plurality of the votes cast by the shares entitled to vote where quorum is present (Mass. Gen. Laws Ch. 156D §7.28(a)).</p>	<p>Maryland corporate law provides that unless the statute or charter provides otherwise, the majority of all votes cast at a meeting at which a quorum is present is sufficient to approve any matter (MD. Code § 2-506). Unless the charter or bylaws provide otherwise, a plurality of all the votes cast at a meeting at which a quorum is present is sufficient to elect a director (MD. Code § 2-404(d)).</p>

	DE Statutory Trusts and Corporations	MA Business Trusts and Corporations	MD Corporations
Special Requirements for Fund Reorganizations (Mergers)	Delaware <u>statutory trust</u> law merely provides that a governing instrument may contain any provision without limitation regarding the accomplishment of a merger, which is not contrary to any provision or requirement of this subchapter (Del. Code Title 12 § 3806(b)(3)).	The Massachusetts <u>business trust</u> statute is silent on this matter (Mass. Gen. Laws Ch, 182). If any provision of <u>general laws</u> requires more than majority vote for approval of the matter, organizational documents may lower the requirement to a majority of all shares eligible to vote on the matter. For voting requirements not dictated by the 1940 Act, common practice is to rely on this provision for mergers (Mass. Gen. Laws Ch. 156D §7.27(b)).	Unless the governing documents otherwise provide, shareholder approval is not required for transfer of assets of a registered open-end investment company (MD. Code § 3-104(a)(5)).



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