

**MEMO# 15623**

February 5, 2003

## **SEC ADOPTS RULES RELATING TO PROXY VOTING BY INVESTMENT COMPANIES AND INVESTMENT ADVISERS**

[15623] February 5, 2003 TO: BOARD OF GOVERNORS No. 5-03 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 8-03 COMPLIANCE ADVISORY COMMITTEE No. 9-03 SEC RULES COMMITTEE No. 12-03 SMALL FUNDS COMMITTEE No. 5-03 RE: SEC ADOPTS RULES RELATING TO PROXY VOTING BY INVESTMENT COMPANIES AND INVESTMENT ADVISERS The Securities and Exchange Commission has adopted amendments to Forms N-1A, N-2, N-3 and N-CSR, new Form N-PX and new Rule 30b1-4 to require registered management investment companies to disclose the policies and procedures that they use to determine how to vote proxies relating to portfolio securities, and to file with the Commission and make available to their shareholders the specific proxy votes that they cast.<sup>1</sup> In addition, the Commission has adopted new Rule 206(4)-6 and amendments to Rule 204-2 under the Investment Advisers Act of 1940 to require registered investment advisers to adopt and implement written policies and procedures reasonably designed to ensure that proxies are voted in the best interests of their clients, disclose to clients information about those policies and procedures, disclose to clients how they may obtain information on how the adviser voted their proxies, and retain records relating to voting proxies on client securities.<sup>2</sup> In addition, the Commission has requested comment on its Paperwork Reduction Act burden estimates with respect to new Form N-PX (proxy voting record). Comments are due to the SEC by March 14, 2003. If you have comments that you would like the Institute to consider including in its letter on the SEC's burden estimates, please provide them to Jennifer Choi by phone at (202) 326-5810 or by email at [jchoi@ici.org](mailto:jchoi@ici.org) by February 19, 2003. The new requirements are summarized below.<sup>3</sup> 1 SEC Release Nos. 33-8188, 34-47304, IC-25922 (January 31, 2003) ("Fund Release"). The Fund Release is available on the SEC's website at [www.sec.gov/rules/final/33-8188.htm](http://www.sec.gov/rules/final/33-8188.htm). 2 SEC Release No. IA-2106 (January 31, 2003) ("Adviser Release"). The Adviser Release is available on the SEC's website at [www.sec.gov/rules/final/ia-2106.htm](http://www.sec.gov/rules/final/ia-2106.htm). 3 See also Memorandum to Closed-End Investment Company Members No. 44-02, Investment Adviser Members No. 39-02, Investment Adviser Associate Members No. 23-02, SEC Rules Members No. 79-02, Small Funds Members No. 37-02, Unit Investment Trust Members No. 26-02, dated September 24, 2002 (SEC proposals relating to proxy voting); Memorandum to Board of Governors No. 40-02, Director Services Committee No. 11-02, Closed-End Investment Company Members No. 64-02, Investment Adviser Members No. 53-02, Investment Adviser Associate Members No. 2 I. Investment Company Proxy Voting A. Disclosure of Policies and Procedures. A mutual fund must disclose in its statement of additional information ("SAI") (and, in the case of a closed-end fund, in its Form N-CSR) the policies and procedures that it uses to

determine how to vote proxies relating to its portfolio securities.<sup>4</sup> This disclosure includes the procedures that a fund uses when a vote presents a conflict between the interests of fund shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter, or an affiliated person of the fund, its investment adviser, or principal underwriter, on the other. It also includes any policies and procedures of a fund's investment adviser, or any other third party, that the fund uses, or that are used on the fund's behalf, to determine how to vote proxies relating to portfolio securities. In the Fund Release, the SEC states that it expects funds' disclosure of their policies and procedures to include general policies and procedures,<sup>5</sup> as well as policies with respect to voting on specific types of issues.<sup>6</sup> In addition, a fund must disclose in its shareholder reports that a description of the fund's proxy voting policies and procedures is available (1) without charge, upon request, by calling a specified toll-free (or collect) telephone number, (2) on the fund's website, if applicable, and (3) on the Commission's website. A fund must send this description of the fund's proxy voting policies and procedures within three business days of receipt of a request, by first-class mail or other means designed to ensure equally prompt delivery.

**B. Disclosure of Proxy Voting Record**

**1. Filing on New Form N-PX.** New Rule 30b1-4 under the Investment Company Act requires a fund to file its complete proxy voting record on an annual basis on new Form N-PX. In particular, a fund must file Form N-PX, containing its complete proxy voting record for the twelve-month period ended June 30, by no later than August 31 of each year. Form N-PX will be a reporting form required under the Investment Company Act and will be required to be signed by the fund, and on behalf of the fund by its principal executive officer(s). Funds will be required to disclose the following information on Form N-PX for each matter relating to a portfolio security considered at any shareholder meeting held during the period covered by the 35-02, SEC Rules Members No. 109-02, Small Funds Members No. 54-02, December 6, 2002 (Institute's comment letter on proxy voting proposals).

<sup>4</sup> A fund may satisfy this requirement for a description of its policies and procedures by including a copy of the policies and procedures themselves in the SAI (or, in the case of closed-end funds, on Form N-CSR).

<sup>5</sup> The Fund Release provides the following examples of general policies and procedures that some funds include in their proxy voting policies and procedures and with respect to which disclosure would be appropriate: (1) the extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party; (2) policies and procedures relating to matters that may affect substantially the rights or privileges of the holders of securities to be voted; and (3) policies regarding the extent to which the fund will support or give weight to the views of the management of the portfolio company.

<sup>6</sup> The Fund Release includes the following examples of specific types of issues that are covered by some funds' proxy voting policies and procedures and with respect to which disclosure would be appropriate: (1) corporate governance matters, including changes in the state of incorporation, mergers and other corporate restructurings, and anti-takeover provisions such as staggered boards, poison pills and supermajority provisions; (2) changes to capital structure, including increases and decreases of capital and preferred stock issuance; (3) stock option plans and other management compensation issues; and (4) social and corporate responsibility issues.

<sup>3</sup> report and with respect to which the fund was entitled to vote: (1) the name of the issuer of the portfolio security; (2) the exchange ticker symbol of the portfolio security; (3) the CUSIP number for the security; (4) the shareholder meeting date; (5) a brief identification of the matter voted on; (6) whether the matter was proposed by the issuer or by a security holder; (7) whether the fund cast its vote on the matter; (8) how the fund cast its vote; and (9) whether the fund cast its vote for or against management.

**2. Availability to Shareholders.** A fund must disclose in its annual and semi-annual reports to shareholders and in its SAI a statement that the fund's proxy voting record for the most recent twelve-month period ending June 30 is available (1)

without charge, upon request, by calling a specified toll-free (or collect) telephone number, or on or through the fund's website at a specified Internet address,<sup>8</sup> or both, and (2) on the Commission's website. If a fund chooses the option of disclosing that its proxy voting record is available by calling a telephone number, it must send the information disclosed in the fund's most recently filed report on Form N-PX within three business days of receipt of a request for the information, by first-class mail or other means designed to ensure equally prompt delivery. Alternatively, if a fund chooses the option of disclosing that its proxy voting record is available on or through its website, it must make available free of charge the information disclosed in the fund's most recently filed report on Form N-PX on or through its website as soon as reasonably practicable after filing the report with the Commission.<sup>9</sup> According to the Fund Release, the SEC interprets the "as soon as reasonably practicable" standard to mean that the information would be available, barring unforeseen circumstances, on the same day as filing.

C. Disclosure of Proxy Votes that are Inconsistent with Fund's Policies and Procedures. As recommended by the Institute, the Commission did not adopt the proposed requirement that a fund disclose in its shareholder reports proxy votes that are inconsistent with the fund's proxy voting policies and procedures.

D. Request for Comment on Burden Estimate. The Fund Release states that the Commission received numerous comment letters concerning the Commission's estimates of the burdens of the proposals, particularly with respect to the proposal to disclose funds' actual proxy voting records. Many commenters, including the Institute, argued that the Commission's estimates substantially underestimated the burden of providing proxy voting information. The Commission has revised its burden estimates in light of the changes made to the proposals, most notably that (1) the disclosure of proxy votes cast in annual reports will be on new Form N-PX rather than semi-annually on Form N-CSR, and (2) funds will not be required to disclose in their annual and semi-annual reports to shareholders votes that were inconsistent with their proxy voting policies and procedures. The Commission requests comment on its burden estimate for filing Form N-PX.

7 A fund may omit the exchange ticker symbol and CUSIP number if it is not available through reasonably practicable means.

8 The Fund Release states that, if a fund is complying with this disclosure requirement, the inclusion of the fund's website address will not, by itself, include or incorporate by reference the information on the site into the fund's shareholder reports or SAI, unless the fund otherwise acts to incorporate the information by reference.

9 The Fund Release notes that a fund could satisfy this requirement by hyperlinking to a third-party service or the SEC's EDGAR website.

4 II. Investment Adviser Proxy Voting

A. Written Policies and Procedures. New Rule 206(4)-6 under the Investment Advisers Act requires advisers subject to the rule<sup>10</sup> to adopt and implement written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients. The policies and procedures must (1) be in writing, (2) be reasonably designed to ensure that the adviser votes in the best interest of clients,<sup>11</sup> and (3) describe how the adviser addresses material conflicts between its interests and those of its clients with respect to proxy voting. According to the Adviser Release, the policies and procedures should address how the adviser will vote proxies (or what factors it will take into consideration) when voting on particular types of matters, such as changes in corporate governance structures, adoption or amendments to compensation plans (including stock options) and matters involving social issues or corporate responsibility. The Adviser Release further states that the policies and procedures of an adviser whose advisory activities are limited to investments in investment companies would address different matters, including, for example, approval of advisory contracts, distribution plans and mergers. The Adviser Release also notes that the rule does not prevent an adviser from having different policies and procedures for different clients. The Adviser Release cites examples of methods that would resolve conflicts of interest between an adviser and its clients. In particular, the SEC

states that, clearly, an adviser's policy of disclosing the conflict to clients and obtaining their consents before voting satisfies the requirements of the rule. In this regard, the SEC notes that an adviser to an investment company would satisfy its fiduciary obligations under the Advisers Act if, before voting the proxies, it fully discloses its conflict to the investment company's board of directors or a committee of the board and obtains the board's or committee's consent or direction to vote the proxies.

**B. Disclosure of How Clients Can Obtain Information on Votes.** Rule 206(4)-6 requires advisers to disclose to clients how they can obtain information from the adviser on how their securities were voted. Such disclosure could be satisfied by including it in the adviser's brochure required under Rule 204-3.

**C. Disclosure to a Client of an Adviser's Policies and Procedures.** Rule 206(4)-6 requires advisers to describe their proxy voting policies and procedures to clients, and upon request, to furnish a copy of them to clients. The Adviser Release states that the description should be a concise summary of the adviser's proxy voting policies and procedures, rather than 10 The rule applies to all SEC-registered investment advisers that exercise proxy voting authority over client securities. The Adviser Release notes that advisers that have implicit as well as explicit voting authority must comply with the new rule; the rule thus applies when the advisory contract is silent but the adviser's voting authority is implied by an overall delegation of discretionary authority. The Adviser Release further indicates that the rule does not apply to advisers that provide clients with advice about voting proxies but do not have authority to vote the proxies, although the Advisers Act's anti-fraud provisions would continue to require such advisers to disclose any material conflict to the clients receiving the advice. 11 According to the Adviser Release, procedures that merely declare that all proxies will be voted in the best interests of clients do not satisfy this requirement. 5 a reiteration of the policies and procedures, and should indicate that a copy of the policies and procedures is available upon request.

**D. Recordkeeping Requirements.** As recommended by the Institute, the SEC has narrowed the proposed recordkeeping requirements. Rule 204-2, as amended, requires advisers to retain (1) their proxy voting policies and procedures, (2) proxy statements received regarding client securities, (3) records of votes they cast on behalf of clients, (4) records of written client requests for proxy voting information and written responses by the adviser to any such written or oral client request, and (5) any documents prepared by the adviser that were material to making a decision how to vote, or that memorialized the basis for the decision. Advisers may rely on the Commission's EDGAR system to meet the requirement that they maintain proxy statements. In addition, advisers may use a third party service provider to maintain proxy statements and proxy votes if the service provider undertakes to provide copies of those records promptly upon request. These records (other than proxy statements on file with the EDGAR system or maintained by a third party and proxy votes maintained by a third party) must be maintained in an easily accessible place for five years, the first two in an appropriate office of the adviser.

**III. Compliance Dates**

**A. Rules under the Investment Company Act.** The final rules will become effective on April 14, 2003. Compliance dates for the requirements are as follows:

- Funds must file their first report on Form N-PX no later than August 31, 2004, for the twelve-month period beginning July 1, 2003 and ending June 30, 2004.
- All registration statements (both initial and post-effective amendments that are annual updates) on Form N-1A, N-2 or N-3 filed on or after July 1, 2003 and all annual reports of closed-end funds on Form N-CSR filed on or after July 1, 2003 must include the disclosure regarding the fund's proxy voting policies and procedures.<sup>12</sup>
- All registration statements (both initial and post-effective amendments that are annual updates) on Form N-1A, N-2 or N-3 filed on or after August 31, 2004 and all shareholder reports transmitted to shareholders on or after August 31, 2004 must include the disclosure regarding the availability of the fund's proxy voting record.
- All shareholder reports transmitted to shareholders on or after the effective date of an initial registration statement

or post-effective amendment that is required to include a description of the fund's proxy voting policies and procedures (or, in the case of a closed-end fund, the filing date of its first annual report on Form N-CSR filed on or after July 1, 2003) must include the disclosure regarding the availability of the fund's proxy voting policies and procedures. B. Rules under the Investment Advisers Act. The final rules will become effective 30 days after publication in the Federal Register. Advisers must comply with the new rule and rule amendments within 180 days after publication in the Federal Register. 12 The Fund Release states that the SEC would not object if existing funds file their first annual update to their registration statements complying with the amendments pursuant to Rule 485(b) under the Securities Act of 1933, provided that the post-effective amendment otherwise meets the conditions for immediate effectiveness under the rule. 6 Anu Dubey Assistant Counsel

---

**Source URL:** <https://icinew-stage.ici.org/memo-15623>

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.