MEMO# 20606

November 22, 2006

Institute Letter to Committee on Capital Markets Regulation

 [20606] November 22, 2006 TO: BOARD OF GOVERNORS No. 27-06 SEC RULES MEMBERS No. 102-06 COMPLIANCE MEMBERS No. 46-06 CLOSED-END INVESTMENT COMPANY MEMBERS No. 56-06 EQUITY MARKETS ADVISORY COMMITTEE No. 25-06 PENSION MEMBERS No. 69-06 TAX MEMBERS No. 42-06 INTERNATIONAL MEMBERS No. 31-06 RE: INSTITUTE LETTER TO COMMITTEE ON CAPITAL MARKETS REGULATION The Institute has filed a letter with the Committee on Capital Markets Regulation, an independent, bipartisan committee composed of corporate and financial leaders, setting forth recommendations on ways to improve the efficiency and competitiveness of the U.S. capital markets. It is our understanding that the Committee plans to issue an interim report containing its recommendations at the end of November 2006 that will address, among other things, the effect of regulation on the efficiency of U.S. capital markets, whether the costs and benefits of regulation are properly taken into account when new regulations are issued, and whether regulation may unintentionally be making our markets less competitive in the global economy. The most significant aspects of the Institute's letter are summarized below. Sarbanes-Oxley Act Reform - The letter supports the Committee's efforts to review requirements under the Sarbanes-Oxley Act. The letter states that the Act's certification requirements applicable to mutual funds, as implemented by the SEC, go beyond the intent of the Act in several significant respects, place a significant and unnecessary burden on fund executive officers, and are duplicative of a number of unique compliance requirements already imposed on mutual funds and not on operating companies subject to the Act. The letter therefore recommends that the Committee consider the impact of the Act on mutual funds. Specifically, the letter recommends that the certification requirements of the Act applicable to mutual funds be withdrawn. At a minimum, a more 2 reasoned approach to regulation should be adopted, e.g., certifications should not be required for non- financial information included in shareholder reports. Point of Sale Disclosure – The letter expresses support for the concept of point of sale disclosure, but not as currently proposed by the SEC. The letter states that the manner in which the SEC has proposed to effectuate this disclosure, and the amount of information that will have to be disclosed, is inconsistent with the manner in which brokers typically sell mutual fund shares. In addition, since other financial products that brokers sell would not be subject to these requirements, brokers are likely to steer their customers to alternative investments that are not subject to these disclosure requirements and do not offer the same level of regulatory protection and other benefits that mutual funds do. The letter therefore recommends that, if the SEC determines to adopt some form of point of sale disclosure requirements for mutual funds, it do so in a manner that is consistent with

the nature of the brokers' business model and that does not create competitive disadvantages for funds. The letter also recommends that any point of sale disclosure requirements utilize the internet as the delivery vehicle of information to investors. Soft Dollars – The letter notes that institutional investors, other than advisers to mutual funds and ERISA pension plans, are not subject to the restrictions of Section 28(e), with the result that they have greater freedom to use soft dollars. The letter states that, when combined with other forces exerting downward pressure on overall commissions, this regulatory disparity may create strong incentives for broker-dealers to favor hedge fund and other types of advisers. The letter therefore urges the Committee to include a recommendation in its report that the Institute has made to the SEC to adopt a rule that would prohibit any investment adviser from using soft dollars to pay for any products or services that fall outside the Section 28(e) safe harbor. The letter also expresses support for a recommendation of an NASD task force that the SEC urge the Department of Labor and the federal banking agencies to require all discretionary investment advisers not subject to the SEC's jurisdiction to comply with the standards of the Section 28(e) safe harbor. Proxy Voting – The letter discusses proxy voting both from the standpoint of funds as investors and as issuers. As investors, the letter notes that funds are the only investors subject to proxy voting disclosure requirements, which has created unintended consequences for fund firms. Among other things, only fund firms are singled out for scrutiny and unnecessary criticism for the manner in which they voted, thereby uniquely politicizing mutual fund portfolio management. The letter recommends that, to the extent that disclosure of proxy voting records is considered to achieve important public policy purposes, these requirements should be applied to all institutional investors. From the perspective of issuers of securities, the letter discusses concerns relating to developments in the voting of proxies by brokers. Specifically, the letter states that a recommendation by an NYSE working group that the election of directors be viewed as a "non-routine" matter on which brokers would not be permitted to vote proxies on behalf of their customers will create significant difficulties for funds and other issuers in achieving quorums and getting directors elected. The letter therefore recommends that brokers should be permitted to continue to vote uninstructed shares on uncontested director elections until certain steps are taken. Only after these efforts are undertaken and all 3 constituents, including the NYSE, are satisfied that shareholders will exercise their voting rights should director elections become "non-routine." Alternatively, the letter recommends that the NYSE permit brokers to exercise "proportional voting" with respect to shares for which voting instructions are not received. Tax Efficiency – The letter strongly supports the GROWTH Act, which would address several burdens on mutual funds by deferring tax on automatically reinvested capital gain distributions until fund shares are sold. The letter states that the GROWTH Act also would help address problems for foreign investors in U.S. funds who incur tax currently in their home countries that would not be incurred if they invested instead in non-U.S. funds. The letter therefore urges the Committee to support adoption of the GROWTH Act. Elizabeth Krentzman General Counsel Attachment (in .pdf format) Note: Not all recipients receive the attachment. To obtain a copy of the attachment, please visit our members website (http://members.ici.org) and search for memo 20606, or call the ICI Library at (202) 326-8304 and request the attachment for memo 20606.