INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

March 27, 2009

ICI Comment Letter on NYSE Proposal Regarding Broker Voting on Elections of Directors, March 2009

March 27, 2009

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NW
Washington, D. C. 20549-1090

Re: Notice of Filing of Proposed Rule Change to Amend NYSE Rule 452 to Eliminate Broker Discretionary Voting for the Election of Directors and Codify Interpretations that Do Not Permit Broker Discretionary Votes for Material Amendments to Investment Advisory Contracts (File No. SR-NYSE-2006-92)

Dear Ms. Murphy:

The Investment Company Institute [1] is writing to provide its views on proposed changes to New York Stock Exchange Rule 452 that would eliminate discretionary broker voting for the election of directors. [2] The proposal is the end product of a lengthy undertaking to examine the proxy voting process. Much of this work was accomplished under the auspices of the NYSE's Proxy Working Group ("Working Group"), a group created by the NYSE in April 2005 to review its rules regulating proxy voting. [3] We commend the Working Group for its thoughtful consideration of comments provided by the investment company industry throughout its examination and welcome the opportunity to provide our comments on the proposal, now that the Securities and Exchange Commission has formally published the proposal for public comment.

I. Background

The Institute held discussions on the proposal with, and provided input to, the Working Group, the NYSE, and the Commission on several occasions throughout the proposal's development. [4] Most significantly, to assist the Working Group and NYSE staff in considering the impact of the proposal on investment companies, the Institute surveyed its members and prepared a report [5] based on the data gathered from the survey. [6]

As discussed in more detail below, the ICI Report concluded that the proposal would have a disproportionate impact on investment companies and would create significant difficulties for investment companies in achieving quorums and electing investment company directors. 7 Accordingly, the Institute urged the Working Group and the NYSE to except investment companies from the proposal.

The Institute supports the proposal, as amended. We are pleased that the Working Group and the NYSE amended the original proposal to preserve discretionary broker voting for investment companies and that they attached particular significance to the findings of the ICI Report.

We recommend, however, that the NYSE make a technical change to the proposed language of amended Rule 452 to clarify that the proposal also excepts business development companies (“BDCs”) that elect to be regulated under the Investment Company Act. As discussed below, we also support the codification in Rule 452 of certain NYSE interpretations regarding investment advisory contracts. Our specific comments on the proposal follow.

II. Impact of Eliminating Discretionary Broker Voting on the Election of Investment Company Directors

The Institute has a long-standing policy of supporting strong corporate governance and agrees that shareholder voting for directors can be an important component of a robust corporate governance structure. As applied to investment companies, however, the proposal would have no demonstrable benefits, and certainly none that come close to offsetting its costs.

As discussed in the ICI Report, the proposal would have adverse effects on investment companies for several reasons. First, the proposal would create significant difficulties for investment companies in achieving quorums, and, in turn, would occasion unnecessary delays in electing investment company directors. In addition, to encourage shareholders to vote their proxies, investment companies would be forced to adjourn meetings and/or engage in multiple solicitations, thereby significantly increasing costs to investment companies. The proposal also would have a disproportionate impact on investment companies as opposed to operating companies. Because investment companies have a far higher proportion of retail shareholders than most operating companies and retail shareholders are less likely than institutional investors to vote their proxies, investment companies would incur disproportionately greater costs from the elimination of discretionary broker voting. Finally, because the elections that are the subject of the NYSE proposal are uncontested, the same directors, in virtually every case, would be elected whether or not investment companies and their shareholders bear these steep additional costs. Therefore, we believe that the current process does not entail any detrimental effects on investment companies or investment company governance.

A. Eliminating Discretionary Broker Voting Would Have a Disproportionate Impact on Investment Companies

Investment companies have a far higher proportion of retail shareholders than most operating companies. Because retail shareholders are less likely than institutional investors to vote their proxies (many institutional investors have a fiduciary responsibility to do so), eliminating discretionary broker voting for investment companies would have a disproportionate impact on investment companies, and investment companies would incur greater costs from the elimination of discretionary broker voting. The ICI Report found that while retail shareholders hold about forty-eight percent of the value of operating company shares, they hold about sixty-four percent of the value of mutual fund shares. This disparity is even greater for closed-end funds, where retail investors own about ninety-eight percent of the value of shares.

The ICI Report reflected data as of year-end 2005, but the data remains consistent. Retail shareholders held about forty-five percent of the value of operating company shares as of December 2008, sixty-four percent of the value of mutual fund shares as of December 2007, and approximately ninety-five percent of closed-end fund shares as of December 2008. 8 We have no reason, therefore, to believe that the findings of the ICI Report would be any different today.

B. Eliminating Discretionary Broker Voting Would Cause Significant Difficulties in Investment Companies Achieving a Quorum

NYSE members hold a substantial portion of investment company shares in street name. 9 The ICI Report found that half of investment companies sold through sales forces had at least 80 percent of the investment company's total shares outstanding held in this manner. The ICI Report also found that beneficial shareholders tend to return their proxies at a fairly low rate – only approximately thirty two percent of investment company shares held in street name were voted by beneficial owners. In contrast, when brokers are permitted to vote uninstructed shares, almost all shares (ninety-three percent) held in street name were voted. A majority of outstanding shares often must be voted for an investment company to achieve a quorum with respect to matters pertaining to the election of directors. If broker voting of investment company shares held in street name was eliminated, significant difficulties for investment companies would be created in achieving a quorum, and, in turn, electing investment company directors. An uncontested director election by its nature is highly unlikely to elicit strong interest or participation from rank and file investment company shareholders, only fifteen percent of whom ascribe significance to information about a mutual fund's directors when selecting a mutual fund, according to an Institute survey. 10

C. Eliminating Discretionary Broker Voting Would Cause Investment Company Proxy Costs to More than Double

Because a significant number of investment company shareholders choose not to vote shares held in street name, investment companies are forced to incur increased costs from taking steps necessary to encourage shareholders to vote their proxies. 11 The ICI Report showed that these costs are significant. Because investment companies would have to engage in multiple solicitations, typical proxy solicitation costs would more than double from $1.65 to $3.68 for each shareholder account. Investment company expense ratios would rise between one to two basis points, on average, with some investment companies' expense ratios increasing more than five basis points. 12 Because the elections that are the subject of the NYSE proposal are uncontested, the same directors will be elected whether or not investment companies bear these increased costs.

III. Business Development Companies Should be Excepted from the Proposal

The amended NYSE proposal would except "registered investment companies" from the elimination of discretionary broker voting. By drafting the exception to include only "registered" investment companies, the exception would not include a segment of the investment company industry known as business development companies, or BDCs.

BDCs share many of the same characteristics of registered investment companies and, most significantly, the two characteristics of investment companies that the Working Group attached particular significance to in creating the exception – the regulatory structure for investment companies under the Investment Company Act and the large retail shareholder base of investment companies. In addition, from what we can tell, it appears that the omission of BDCs from the exception was unintentional, as the discussion in the ICI Report and prior comment letters, as well as in the NYSE's amended proposals (and its discussion of the Working Group's views in those proposals) refer only to "investment companies" and not to "registered investment companies." 13

It would therefore be consistent with the Working Group's reasoning to treat BDCs for purposes of the proposal in the same manner as registered investment companies. 14

A. BDC Regulatory Structure is Akin to Registered Investment Companies

BDCs are "investment companies," as defined in the Investment Company Act, because they are primarily engaged in investing, reinvesting, or trading in securities. 15 They are considered a type of closed-end investment company, formed primarily to assist small businesses by furnishing them with capital through purchasing their securities and offering them significant managerial assistance. 16 The Investment Company Act prescribes a regulatory regime for BDCs to facilitate the formation of capital for small businesses. 17 Under that regulatory scheme, BDCs are not required to register under the Investment Company Act and, thus, technically are not "registered investment companies." They do, however, elect to be regulated under the Investment Company Act and are subject to many of the same corporate governance requirements as registered investment companies.

For example, a majority of a business development company's directors must be independent; 18 certain persons are prohibited from serving as employees, officers, directors, or investment advisers of a BDC; 19 a BDC's contract with its investment adviser (and any material amendments thereto) must be approved by a majority of its outstanding voting securities; the advisory contract may only continue for more than two years if the board or a majority of outstanding voting securities approves its continuance annually; a majority of independent directors must approve advisory contracts and renewals thereof; 20 independent directors must select a BDC's independent auditor; 21 and a BDC may not change the nature of its business so as to cease to be a BDC without the approval of a majority of its outstanding voting securities. 22

B. BDCs Have a Large Retail Shareholder Base

Like registered investment companies, BDCs have a far higher proportion of retail shareholders than most operating companies. An estimated sixty-three percent of BDC shares, on average, are held by retail investors. 23 Because these shareholders tend to vote at a fairly low rate, BDCs would be subject to the same increased costs and burdens that would be experienced by registered investment companies if discretionary broker voting is eliminated for the election of directors. 24

IV. Voting on Investment Advisory Contracts

The proposal would preclude discretionary broker voting on: (i) a material amendment to an investment company's investment advisory contract; and (ii) an investment company's investment advisory contract with a new investment adviser, which approval is required by the Investment Company Act and the rules thereunder. 25 The Release notes that the proposed change would codify longstanding NYSE interpretations on these issues. We support the codification of these interpretations in Rule 452.

We agree that these matters are the types of non-routine matters on which investment company shareholders should be required to vote. As a legal matter, investment companies generally are organized as corporations or business trusts with a board of directors or trustees. Practically speaking, however, investment companies are a means through which investors obtain the services of the investment company's investment adviser. When investors become shareholders of an investment company, they already have chosen the adviser in the context of the disclosures in the investment company's prospectus and other documents that set forth the material facts concerning the adviser, the investment company's investment objectives, strategy and risks, the management fee structure, and other expenses of investing in the investment company. 26 Given the importance of the identity of the adviser and the services it provides to investment company shareholders, we believe the benefits of shareholders' voting on a material amendment to an advisory contract or an advisory contract with a new investment adviser outweigh the costs associated with such a requirement.

* * *

We offer our continued assistance as the Working Group and the NYSE continue to examine these and other issues surrounding broker voting. If you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5815, Ari Burstein at (202) 371-5408, or Dorothy M. Donohue at (202) 218-3563.

Sincerely,

/s/ Karrie McMillan
Karrie McMillan
General Counsel

cc: The Honorable Mary L. Schapiro
The Honorable Kathleen L. Casey
The Honorable Elisse B. Walter
The Honorable Luis A. Aguilar
The Honorable Troy A. Paredes
Andrew J. Donohue, Director, Division of Investment Management
Erik R. Sirri, Director, Division of Market Regulation
U.S. Securities and Exchange Commission
Scott Cutler, Executive Vice President
Judith C. McLevey, Managing Director
John Carey, Chief Counsel – U.S. Equities
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ENDNOTES

1 The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards,

promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $9.88 trillion and serve over 93 million shareholders.

2 See Securities Exchange Act Release No. 59464 (February 26, 2009), 74 FR 9864 (March 6, 2009).

3 See Report and Recommendations of the Proxy Working Group to the New York Stock Exchange (June 5, 2006).

4 See Letter from Frances M. Stadler, Deputy Senior Counsel, Investment Company Institute, to Mr. Larry Sonsini, Chairman, NYSE Proxy Working Group, Wilson, Sonsini, Goodrich & Rosati, dated June 3, 2005; Letter from Elizabeth R. Krentzman, General Counsel, Investment Company Institute, to Catherine R. Kinney, President and Chief Operating Officer, NYSE Group, dated July 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to Richard Ketchum, Chief Executive Officer, NYSE Regulation, dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to Catherine R. Kinney, President and Co-Chief Operating Officer, NYSE Group, Inc., dated December 18, 2006; Letter from Paul Schott Stevens, President, Investment Company Institute, to The Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated February 20, 2007; and Statement of Paul Schott Stevens, President and CEO, Investment Company Institute before the SEC Proxy Roundtable, dated May 24, 2007.

5 See Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors (December 18, 2006) (“ICI Report”). A copy of the ICI Report is attached as Appendix A.

6 The ICI Report also was based on data provided by Automatic Data Processing, Inc. (now known as Broadridge Financial Solutions, Inc.) which reviewed a large number of shareholder meetings and provided the Institute with additional information necessary to assess the effect of the proposal on the ability of investment companies to obtain the required quorum and votes needed to elect directors.

7 Other groups shared the Institute’s view on the impact of the proposal on investment companies. For example, the Committee on Capital Markets Regulation, an independent, bipartisan committee composed of corporate and financial leaders established to set forth recommendations on ways to improve the efficiency and competitiveness of the U.S. capital markets, acknowledged the difficulties that the proposal would cause for investment companies. While the Committee supported the application of the NYSE proposal to corporate issuers in its interim report, the Committee stated that it believes that the application of the proposal to voting by investment company shareholders “should be reconsidered in light of the practicalities of such situations.” See Interim Report of the Committee on Capital Markets Regulation, November 30, 2006 (as revised December 5, 2006) at p. 128.

8 We have provided the most recent data available for each type of company. With respect to operating companies, we based our calculation on data from the World Federation of Exchanges and the Federal Reserve Board; with respect to mutual funds, we used data from the ICI Institutional Survey and the Federal Reserve Board; with respect to closed-end

funds, we used data from two large closed-end fund complexes with close to thirty percent of total closed-end fund assets under management. We used these same data sources for the ICI Report.

9 The proposal applies to proxies relating to investment companies whose shares are held through NYSE member firms.

10 See Understanding Investor Preferences for Information, Investment Company Institute (2006).

11 To obtain approval of matters on which brokers are not permitted to vote (“non-routine matters”), it is frequently necessary for investment companies to engage soliciting firms and conduct multiple mailings, the cost of which can be significant. Even with these measures, investment companies often must adjourn meetings due to an insufficient voting response. The ICI Report indicated that no shareholder meeting in our entire sample with only routine matters on the agenda required a re-solicitation of shareholders or was adjourned for lack of a quorum. This result was due to the high rate at which brokers vote. In contrast, more than half of shareholder meetings in our sample with at least one non-routine matter required at least one re-solicitation.

12 These expected increases in expense ratios from eliminating broker voting are about on par with the cost of custody fees, a basic service provided to all investment companies, as required by the Investment Company Act, to protect assets.

13 For example, the Working Group stated it “reviewed and considered the fact that that investment companies are subject to regulation under the Investment Company Act of 1940” and that it “unanimously recommends that such changes to Rule 452 not apply to any company subject to the Investment Company Act of 1940.” See Addendum to Report and Recommendations of the Proxy Working Group to the New York Stock Exchange (August 27, 2007) at p. 3.

14 Appendix B contains recommended draft language that could be used to effectuate this change.

15 See Section 3(a)(3) of the Investment Company Act (defining investment company).

16 See Section 2(a)(48) of the Investment Company Act (defining business development company as a domestic closed-end investment company, operated for the purpose of making certain types of investments, which makes available significant managerial assistance to the companies in which it invests).

17 See Section 55(a)(2) of the Investment Company Act (requiring seventy percent of a business development company’s assets to be invested in, among other things, securities purchased in a nonpublic offering from an eligible portfolio company).

18 See Section 56 of the Investment Company Act. This particular provision imposes a more stringent requirement on BDCs as compared to registered investment companies. While a majority of a BDC’s directors must not be “interested persons” (a defined term in Section 2(a)(19) of the Investment Company Act), forty percent of registered investment company’s directors must not be interested persons. In practice, both registered investment companies and BDCs greatly exceed the statutory requirements by typically having 75% of their boards comprised of independent directors.

19 See Section 59 of the Investment Company Act. The persons subject to this prohibition include persons convicted within the last ten years of certain felonies or misdemeanors involving specified securities-related activities, and persons temporarily or permanently enjoined from engaging in certain securities-related activities.

20 See Section 59 (applying Sections 15(a) and (c) of the Investment Company Act to BDCs to the same extent that the provisions apply to registered closed-end investment companies).

21 See Section 59 (applying Section 32(a) of the Investment Company Act to BDCs to the same extent that the provision applies to registered closed-end investment companies).

22 See Section 58 of the Investment Company Act. There are some additional Investment Company Act requirements that apply to shareholders of registered investment companies and not to BDC shareholders. Section 13 of the Investment Company Act requires shareholder approval for a registered investment company to change from an open-end, closed-end, diversified, or non-diversified company; to 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 accordance with the policy in its registration statement; or to deviate from a stated policy with respect to concentration of investments in an industry or industries, from any investment policy which is changeable only by shareholder vote, from any stated fundamental policy, or to change the nature of its business so as to cease to be an investment company. As explained in the legislative history accompanying the legislation that created BDCs, these provisions do not apply to BDCs because the Investment Company Act prescribes the limits of the fundamental investment policy of a BDC and because BDCs represented that, in order to effectively provide financing to new small and medium-sized companies, their investment policies must be flexible. See S. Rep. No. 958, 96th Cong., 2d Sess. at 33 (1980) and H.R. Rep. No. 1341, 96th Cong., 2d Sess. at 51-52.

23 This percentage is based on individual ownership data gathered from http://finance.yahoo.com.

24 One Institute BDC member recently reported spending $1.4 million to solicit shareholders on a non-routine matter. The meeting was adjourned twice for failure to achieve a quorum, costing approximately $7.70 per shareholder account.

25 For example, broker discretionary voting is not permitted with respect to an advisory contract between an investment company and a new investment adviser due to an assignment of the investment company’s investment advisory contract, including an assignment caused by a change in control of the investment adviser that is a party to the assigned contract.

26 See e.g., Jaretzki, Jr. Alfred, “Duties and Responsibilities of Directors of Mutual Funds,” 29 Law and Contemporary Problems 777, 786 (1964) (stating that as a draftsman of the Investment Company Act pointed out, “The board of directors does not act in a vacuum … The stockholders either have chosen the existing management or they have bought their shares in probable reliance on such management. Presumably, they have confidence in the management and would not expect the directors to take action to change it except in unusual circumstances.”).