

COMMENT LETTER

July 18, 2006

ICI Comment Letter on NYSE Proxy Working Group Report (pdf)

July 18, 2006 Catherine R. Kinney President and Co-Chief Operating Officer NYSE Group, Inc. 11 Wall Street New York, NY 10005 Re: Report and Recommendations of the Proxy Working Group to the New York Stock Exchange Dear Ms. Kinney: The Investment Company Institute¹ welcomes the opportunity to provide its views on the New York Stock Exchange's Proxy Working Group Report.² The Report reflects the work of many participants in the corporate community over the course of more than a year. It analyzes the proxy process and concludes that it is an integrated process in need of several improvements. In particular, it recommends that the election of directors be classified as a "non-routine" matter on which brokers would not be permitted to vote unless instructed how to do so by their customers who beneficially own the stock. The Report also identifies several other aspects of the proxy process that deserve evaluation and possible change and recommends that they be studied in the future. The Institute agrees with the Working Group's observation that shareholder voting for directors is an important component of good corporate governance. The Institute believes, however, that the Working Group's recommendation puts all issuers, including investment companies, "between a rock and a hard place" because shareholders typically do not understand the proxy process, typically choose not to vote, and in most cases, cannot be contacted by the issuers who would urge them to vote. As a result, if brokers are not permitted to vote on uncontested elections of directors, funds and other issuers will have significant difficulties in achieving quorums and getting directors elected. 1 The Institute is the national association of the U.S. investment company industry. More information about the Institute is attached to this letter. 2 See Report and Recommendations of the Proxy Working Group to the New York Stock Exchange (June 5, 2006) ("Report"). The Institute previously provided its views on proxy voting issues to the Working Group. 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 ("2005 Institute Letter"). Ms. Catherine R. Kinney July 18, 2006 Page 2 These concerns are not theoretical. Our members report significant difficulties in achieving quorums and getting matters approved when brokers are not permitted to vote. To get matters approved, it is frequently necessary for funds to engage soliciting firms and conduct multiple mailings. The costs of these measures can be significant. Even with these measures, funds often must adjourn meetings due to an inadequate voting response. Changing approval of directors from a "routine" to a "non-routine" matter will greatly exacerbate this problem. According to a proxy service firm, if brokers are not permitted to vote uninstructed shares, the cost of proxy votes could increase by thirty to forty percent for funds. Because of these concerns, we recommend that the NYSE continue to allow brokers to vote uninstructed shares on uncontested

director elections until certain steps are taken. Educating shareholders about the proxy process and the importance of voting so as to improve shareholder responsiveness to proxies is the appropriate first response to this issue, given the significance of shareholder voting for directors. In addition, Securities and Exchange Commission rules should be revised to permit issuers to contact their shareholders (or their nominees in certain cases). Only after these efforts are undertaken and all constituents, including the NYSE, are satisfied that shareholders will exercise their voting rights should director elections become "non-routine." The Institute stands ready to assist the NYSE in any way it can to achieve these goals. We recognize that changing the dynamics of the proxy process in a way that results in individual beneficial shareholders choosing to exercise their voting rights may be a difficult task that will take some time. If the NYSE chooses not to wait for this change in shareholder behavior before prohibiting brokers from voting on directors, we urge the NYSE to permit brokers to exercise proportional voting with respect to shares for which voting instructions are not received. In addition, we urge the NYSE to make further changes to its corporate governance requirements, including exempting closed-end funds from the NYSE's annual meeting requirement. Because closed-end funds are already subject to voting requirements under the Investment Company Act of 1940, which are intended to ensure shareholder participation in key decisions affecting the fund, the NYSE's requirement is unnecessary. * * * Background Funds have an interest in proxy voting from the perspective of both investors and issuers. As investors, funds vote proxies at annual and special meetings of shareholders. As issuers, funds hold meetings of shareholders when required by state law and/or the Investment Company Act of 1940 and as needed to conduct corporate business. Closed-end funds listed on the NYSE and other exchanges are required to hold annual shareholder meetings irrespective of the specific matter being presented for a vote. The vast majority of open-end and closed-end fund shares are sold through NYSE member firms, which are subject to NYSE Rule 452. As a result, they will not be permitted to vote uninstructed Ms. Catherine R. Kinney July 18, 2006 Page 3 shares on the election of fund directors if the Working Group's recommendation is implemented. Therefore, the Institute has a keen interest in the Report's recommendations. Our comments below focus on issues affecting funds as issuers of voting securities.³ Prohibiting Brokers from Voting on Directors Implementing the Working Group's recommendation to make the election of directors a "non-routine" matter at this time raises significant practical problems as previously discussed. We recommend that the NYSE continue to allow brokers to vote uninstructed shares on uncontested director elections until: (i) shareholders are sufficiently educated about the proxy process and the importance of voting so that they exercise their right to vote; and (ii) the SEC revises its rules to permit issuers to contact their shareholders. Shareholder Education. As the Report points out, there appears to be "widespread ignorance" of the proxy process. Significantly, research conducted at the request of the Working Group shows that few investors realize the significant burdens and costs that are often incurred if they do not send in their proxy votes. We therefore recommend that the NYSE conduct an aggressive education campaign to address the central issue of shareholder apathy and encourage more investors to choose to exercise their voting rights. An education campaign should be a collaborative effort among regulators, broker-dealers, issuers, and other participants in the proxy process and could include leveraging the Internet to provide shareholders with immediate and interactive information about the proxy process. Communication Between Issuers and Shareholders. A majority of shares, including investment company shares, are held in "street name," by brokers, banks, or their depositories. Seventy-five percent of shares held in street name are owned by shareholders who have indicated that issuers may not contact them.⁴ We understand that this percentage may rise because broker-dealers increasingly are setting up accounts as OBOs if their clients do not indicate a preference either way. This feature of

the proxy process presents a significant obstacle for issuers trying to obtain a quorum and get matters approved when only beneficial owners, not brokers, are permitted to vote. 3 As investors, funds consider the voting of proxies of companies in which they invest to be part of the investment process. Accordingly, the vast majority of proxies that funds receive are voted. Therefore, whether the election of directors is deemed a routine or a non-routine matter will have little, if any, effect on the voting practices of funds as investors. See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 6, 2002 (Institute letter regarding proxy voting by investment companies and investment advisers). To the extent that the companies in which funds invest are subject to higher costs in connection with solicitation of proxies, funds will share that burden along with other investors in the company. 4 Shareholders choose whether issuers may contact them. Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs." Shareholders who do not object to having their names and addresses given to issuers are called "Non- Objecting Beneficial Owners" or "NOBOs." SEC rules prohibit banks and brokers from providing issuers with the names of OBOs. Ms. Catherine R. Kinney July 18, 2006 Page 4 We therefore recommend that SEC rules be amended to eliminate the NOBO/OBO distinction and permit investors who choose to remain anonymous to appoint a nominee who could be contacted by issuers. 5 Permitting issuers to communicate with their shareholders (or their nominees) will enable them to "get out the vote," enhancing their ability to obtain needed quorums and successfully resolicit shareholders, if necessary. Proportional Voting One alternative considered, but rejected, by the Working Group was to adopt a proportional voting system as an alternative to existing Rule 452. Under this approach, uninstructed shares would be voted in the same proportion as instructed shares. Proportional voting has important practical advantages. 6 It permits issuers to achieve quorums and directors to be elected. Beneficial owners who choose to vote -- not brokers -- determine the outcome of a director election. In addition, permitting proportional voting is consistent with the NYSE's treatment of voting with respect to auction rate preferred stock⁷ and provisions governing fund voting under the Investment Company Act.⁸ Therefore, if the NYSE limits broker voting as the Working Group recommends without first improving shareholder responsiveness to proxies, the Institute urges the NYSE to permit brokers to 5 It is important to permit investors to keep their identities confidential if they so choose. For example, an institutional investor in the process of increasing its stake in a particular issuer may not want to disclose its current trading activity or ownership position to company management or others. Preserving the confidentiality of trading information is an issue of great concern to the Institute and its members. See, e.g., Letter from Paul Schott Stevens, President, Investment Company Institute, to the Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated September 14, 2005. The Business Roundtable has recommended this approach to the SEC. See, e.g., Letter from Steve Odland, Chairman, Corporate Governance Task Force, Business Roundtable, to Jonathan G. Katz, Secretary, U.S Securities and Exchange Commission, dated April 12, 2004. 6 The Institute previously recommended that the NYSE allow proportional voting if the Working Group recommended substantial changes to proxy voting by brokers. See 2005 Institute Letter. The Working Group stated that one difficulty with proportional voting was determining how to tabulate votes, noting that proportional voting could be tied to voting that occurs at the individual broker level or to the aggregate voting of all record holders. We believe that these considerations are outweighed by the practical benefits that any method of proportional voting will achieve. While we would support the adoption of proportional voting at either the individual broker level or as an aggregation of the voting of all record holders, we recognize that it would be easier, as a practical matter, to permit proportional voting at the individual broker level. To address concerns regarding

the potential for manipulating votes at the broker level, the NYSE could require brokers to adopt and implement written policies and procedures for voting and to maintain related voting records. See, e.g., Rule 206(4)-6 under the Investment Advisers Act of 1940 (requiring investment advisers to adopt written policies and procedures that are reasonably designed to ensure voting of client securities in the best interests of clients). 7 See Rule 452.12. 8 Proportional voting is required under Section 12(d)(1)(E) of the Investment Company Act and is also used in other situations. Section 12(d)(1)(E) concerns an investment company whose only assets are shares of another registered open-end or closed-end investment company. Ms. Catherine R. Kinney July 18, 2006 Page 5 implement proportional voting.⁹ To avoid allowing a matter to be approved by just a few shareholders, we recommend that the NYSE permit proportional voting only in instances where a minimum number of beneficial owners vote or, alternatively, a minimum percentage of shares outstanding are voted.¹⁰ Exclusion of Money Market Funds Regardless of the approach the NYSE decides to take regarding the voting of uninstructed shares, we recommend that NYSE member firms be permitted to vote uninstructed proxies in uncontested elections of directors of money market funds. Beneficial owners of money market funds consider these investments to be an alternative to bank accounts rather than investments in corporate issuers. As a result, even with education of shareholders and enhanced communication between shareholders and issuers, we believe that few, if any, money market fund shareholders will choose to vote. Elimination of Annual Meeting Requirement for Closed-End Funds NYSE Listed Company Manual Rule 302.00 requires closed-end funds to hold annual shareholder meetings. For many years, the Institute and its closed-end fund members have believed that this requirement is unnecessary because closed-end funds are already subject to voting requirements under the Investment Company Act, which are designed to ensure that shareholders participate in what are considered to be the most significant decisions concerning the fund.¹¹ In addition, we believe that in view of the fact that federal and, in many instances, state regulators¹² have concluded that it is not necessary for closed-end funds to have annual shareholder meetings, the NYSE should exempt closed-end funds from its annual shareholder meeting requirement. There are significant costs associated with holding annual meetings due to difficulties in obtaining a quorum, which then forces adjournments and resolicitations. These costs will be increased if the Working Group's recommendation is implemented. 9 Alternatively, we would not object to the NYSE permitting brokers the limited authority to vote uninstructed proxies at shareholder meetings solely for quorum purposes. This approach balances the need of companies to attain quorums so that they can conduct their business while limiting the ability of brokers to determine the outcome of non-routine matters. 10 Whatever minimum is chosen will have to take into account the ability of issuers to contact shareholders to get out the vote, including the percentage of shares held in OBO accounts. 11 For example, Section 13 requires a shareholder vote before an investment company may change certain investment and other policies, Section 15 requires shareholder approval of the investment management agreement between the fund and its investment adviser, Section 16 requires that an investment company's initial board of directors be elected by shareholders, and Section 32 requires that a fund's independent public accountant be approved by the shareholders under certain circumstances. 12 Many closed-end funds are domiciled in jurisdictions that do not require annual meetings. For example, many closed-end funds are Massachusetts business trusts, which are not required to hold annual shareholder meetings. In addition, a number of closed-end funds are incorporated in Maryland, which requires a fund to hold a shareholder meeting only when required by the Investment Company Act. Ms. Catherine R. Kinney July 18, 2006 Page 6 Therefore, we recommend that the NYSE exempt closed-end funds from its annual meeting requirement. At the very least, we urge the NYSE to scale back the shareholder meeting

requirement for closed-end funds to once every three years. Other Issues A great deal of concern was expressed to the Working Group about the increasing role and influence of shareholder advisory services in the proxy system. We agree with the Working Group's recommendation that a study of these services should be undertaken. Shareholder advisory services and proxy voting groups are situated similarly to brokers in that they often make voting decisions with respect to shares in which they do not have an economic interest. However, these entities are not subject to the disclosure or other obligations imposed on brokers by the federal securities laws and are not subject to NYSE, SEC, or any other regulatory oversight. Thus, the combination of the absence of regulation and oversight, and the exercise of voting power may have negative ramifications for the proxy process that warrant study. The Working Group also recommends that the NYSE engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid under NYSE Rule 465. It recommends that the third party analysis include a study of ADP's performance and business process by which it distributes proxies.¹³ Following the study, it recommends that the NYSE consider revising the existing fee schedule and related issues as appropriate. The Institute agrees that an analysis is warranted, especially given that virtually all banks and brokers contract out the administrative process for proxy mailings to one vendor. * * * The Institute appreciates the opportunity to provide its views on the Report. The Report discusses the many facets of the proxy process and identifies significant issues that are worthy of further study. We urge the NYSE to address the practical difficulties that will be created by the Working Group's recommendation before eliminating the right of brokers to vote uninstructed shares on the election of directors. 13 We understand that with respect to contested proxy solicitations, ADP has a set of informal procedural rules for soliciting and counting proxies. As part of its overall assessment of the proxy process, we recommend that the NYSE study and make recommendations regarding these procedures with the goal of helping to ensure fairness to all participants in contested proxy solicitations. Ms. Catherine R. Kinney July 18, 2006 Page 7 If you have any questions regarding our comments or would like additional information, please contact the undersigned at 202.326-5815, Amy Lancellotta at 202.321-5824, or Dorothy M. Donohue at 202.218-3563. Sincerely, /s/ Elizabeth R. Krentzman General Counsel cc: Mr. Stephen Walsh Vice President, Operations New York Stock Exchange, Inc. Mr. Christopher Larsen Client Services New York Stock Exchange, Inc. Ms. Anne Marie Tierney Assistant General Counsel New York Stock Exchange, Inc. Mr. Andrew Donohue Director, Division of Investment Management U.S. Securities and Exchange Commission About the Investment Company Institute ICI members include 8,712 open-end investment companies (mutual funds), 653 closed-end investment companies, 177 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$9.212 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 89.5 million shareholders in more than 52.6 million households