INVESTMENT COMPANY INSTITUTE®

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June 11, 2019

Ms. Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE Washington, DC 20549

Re: SEC Roundtable on the Proxy Process (File No. 4-725)

Dear Ms. Countryman:

The Investment Company Institute[1] appreciates the Commission's efforts in examining proxy issues. Proxy voting is important to registered investment companies (generally "funds") in their dual roles as institutional investors and issuers. ICI previously submitted recommendations addressing topics discussed at the SEC's November roundtable on the proxy process ("Proxy Roundtable"), primarily from the vantage point of funds as institutional investors. We suggested improving communication among public companies, proxy advisory firms, and investors; reevaluating the resubmission thresholds for shareholder proposals; and leveraging technology to improve the mechanics of confirming proxy votes.[2]

We now are submitting additional recommendations for improving the proxy system for funds and their shareholders. As issuers, funds prepare proxy materials in connection with their shareholder meetings and experience all of the challenges that accompany that process. In many respects, however, funds' challenges are even more severe than those of other issuers, given their large and diverse retail shareholder population. Retail shareholders are far less likely to vote than institutional investors, which significantly increases the costs and complexity of funds' proxy solicitations. Accordingly, funds and

[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$23.1 trillion in the United States, serving more than 100 million US shareholders, and US$6.9 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *See* Letter from Paul Schott Stevens, President and CEO, ICI, to Ms. Vanessa Countryman, Acting Secretary, SEC, dated March 15, 2019, available at www.sec.gov/comments/4-725/4725-5124158-183336.pdf. *See also* Letter from Paul Schott Stevens, President and CEO, ICI, to Mr. Brent J. Fields, Secretary, SEC, dated November 14, 2018, available at www.sec.gov/comments/4-725/4725-4702049-176465.pdf.

their shareholders have a strong interest in improving the proxy system to make fund proxy communications with shareholders more effective and cost-efficient.

Section I below describes aspects of the proxy process that prove so costly and cumbersome for funds and their shareholders. We highlight the salient differences between funds and operating companies, present data from a 2018 ICI survey on funds' recent proxy campaigns, and describe fund proxy solicitations.

Section II recommends ways to better align the benefits and costs of funds' proxy requirements and facilitate funds' proxy solicitations. Specifically, we recommend that the SEC:

- Rationalize certain shareholder approval requirements in the Investment Company Act to better reflect modern realities of the securities markets and funds' relationships with their shareholders;
- Create an additional way for funds to achieve a "majority vote" where an overwhelming majority of voting shareholders support an item; and
- Permit funds to deliver proxy materials to, and communicate with, their beneficial shareholders directly in connection with proxy proposals.

Section III recommends that the SEC:

- Permit funds to include a proxy card with the initial proxy notice (for those using the "notice and access" model for delivering proxy materials); and
- Permit funds to link, layer, and more easily incorporate information by reference in their proxy statements.

We stand ready to assist the SEC in any way as it moves forward with this initiative.

I. Proxy Challenges for Funds and Their Shareholders

Funds face more daunting challenges than operating companies to achieve a quorum and get proxy matters approved. This is due to major differences in shareholder bases (funds have more diffuse and retail-oriented shareholder bases), proxy voting behavior of those bases (institutional investors that comprise a larger percentage of operating companies' shareholder bases are far more likely to vote), and organizational differences.[3] These factors contribute significantly to the costs and effort required to seek and obtain necessary shareholder approvals for fund matters.

First, funds often have large numbers of shareholders, consisting predominantly of retail investors. Collectively, funds have over 100 million US shareholders.[4] Retail investors (*i.e.*, households) held the

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[3] For example, because funds often have a single board of directors that oversees multiple funds, open-end funds commonly prepare lengthy combined proxy statements.

[4] Investment Company Institute. 2019. *2019 Investment Company Fact Book: A Review of Trends and Activities*

vast majority (89 percent) of the $17.7 trillion in US mutual fund total net assets at year-end 2018.[5] The extent of retail ownership of fund shares has gradually climbed in recent decades, from 76 percent in 1990 to 80 percent in 2000.[6] In sharp contrast, retail share ownership of public companies was 30 percent in 2018,[7] about a third of funds' retail ownership percentage.

Institutional investors are far more likely to vote proxies than retail investors. As Chairman Clayton noted, "In the 2017 proxy season, retail shareholders voted approximately 29% of their shares, while institutional investors voted approximately 91% of their shares."[8] These participation percentages have held steady over the past five years, including 2018.[9] Unlike operating companies, funds often do not have large blocks of institutional investors upon whom they can depend to vote. Instead, funds must painstakingly canvass retail shareholders to convince them to vote. Funds often struggle to obtain a quorum for some proxy proposals, and adjournments are commonplace.

Also, funds have difficulty even reaching their shareholders. Fund shareholders invest largely through intermediaries, and their shares are held by the fund in omnibus accounts in the intermediaries' names. In some cases, multiple layers of intermediation separate a fund from its ultimate beneficial shareholders, adding to funds' communication challenges. Further, SEC rules limit the ability of funds to contact their beneficial owners. Funds may not contact directly their "objecting beneficial owners" (OBOs) (*i.e.*, shareholders who have objected to the disclosure of their identities and share positions). SEC rules further govern when a fund may obtain a list of its shareholders who have *not* objected to such disclosure (*i.e.*, "non-objecting beneficial owners," or NOBOs).

As a practical matter, funds currently do not send fund materials to NOBOs directly because these NOBO lists lack sufficient identifying information, and the fee imposed by the NYSE for obtaining these lists is prohibitively high.[10] Consequently, a fund may not know the identities of a large

in the Investment Company Industry ("ICI Fact Book"), at 30, available at www.icifactbook.org.

[5] *Id.* at 58.

[6] Investment Company Institute. 2001. *2001 Investment Company Fact Book*, at 43, available at www.ici.org/pdf/2001_factbook.pdf.

[7] ProxyPulse, *2018 Proxy Season Review* (October 2018), at 4, available at www.broadridge.com/_assets/pdf/broadridge-2018-proxy-season-review.pdf.

[8] *See Statement Announcing SEC Staff Roundtable on the Proxy Process* (July 30, 2018), available at www.sec.gov/news/public-statement/statement-announcing-sec-staff-roundtable-proxy-process (citing ProxyPulse, 2017 Proxy Season Review (September 2017)).

[9] *See supra*, note 7, at 4.

[10] *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 ("Processing Fee Letter"), for a more detailed discussion of these matters.

percentage of its shareholders. This severely limits the fund's ability to communicate with its shareholders to encourage voting.

Finally, fund proxy materials are frequently voluminous. Open-end funds (*i.e.*, mutual funds and ETFs) comprise the largest percentage of registered funds, measured in both overall numbers of funds (68 percent) and assets under management (99 percent).[11] Often, it is director elections that trigger an open-end fund's scheduling of a shareholder meeting and preparation of proxy materials. Because a board of directors typically oversees multiple funds within a complex,[12] funds combine the proxy statements of numerous funds to save costs, and the combined proxy statements include information that is both common to the funds (*e.g.*, director nominee information) and fund-specific (*e.g.*, beneficial ownership information for each fund).

In late 2018, ICI surveyed its members about their two most recent fund proxy campaigns.[13] The results are startling and confirm what we frequently hear from members:

- 43 percent of respondents' proxy solicitations included 100,000 or more accounts, with almost 20 percent exceeding 2 million accounts.
- Nearly 80 percent indicated that a majority (and in some cases, all) of their fund shareholders invested through intermediary omnibus positions.
- 93 percent of respondents hired a proxy solicitation firm to assist with the solicitation process.
- The majority of respondents' (53 percent) solicitation processes took over 60 days, and 10 percent took more than 120 days.[14]
- 37 percent adjourned a shareholder meeting for lack of quorum; of those that adjourned, 36 percent did so two or more times.

Our survey established that fund proxy costs are staggering:

- 19 respondents indicated that the total costs of their proxy campaigns were $1 million or more.
- Five campaigns exceeded $10 million.
- The largest cost for a single proxy campaign exceeded $100 million.

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[11] ICI Fact Book at 50 and 32.

[12] Independent Directors Council's and ICI's biennial survey of fund governance practices as of year-end 2016 (which included 9,119 funds) found that (i) 87 percent of participating complexes had a unitary board structure (*i.e.*, a single board that oversees all funds in the complex), and (ii) the average number of funds overseen by independent directors was 58, and the median number was 40.

[13] Fifty-two ICI member firms responded, representing approximately 71 percent of US registered fund assets as of November 30, 2018. Eighty-five percent of respondents conducted a proxy campaign in 2017 or 2018 and provided data for 75 total proxy campaigns (some respondents provided data for two campaigns).

[14] In some cases, funds are under significant pressure to obtain shareholder approval. For instance, a fund may have in place an interim advisory agreement under Rule 15a-4 (*e.g.*, because of a change in control of the investment adviser) with a duration of no more than 150 days.

These costs show no signs of abating. One member estimates that its 2019 multi-fund proxy campaign exceeded $31 million.

These figures may understate total costs. In most cases we believe members providing these estimates understandably did not attempt to quantify and include internal costs associated with their proxy campaigns (*e.g.*, personnel time spent preparing proxy materials, assisting with and overseeing the solicitation process, *etc.*), or the related opportunity costs (*e.g.*, diversion of resources that would have otherwise been employed more beneficially).

Funds—and therefore fund shareholders—often bear these proxy costs.[15] And the costs associated with follow-up solicitations (*i.e.*, the costs incurred following preparation of the materials and the first distribution) largely drive these overall numbers. The member firm reporting the $100 million plus proxy campaign estimates that over half of this total—$56 million—consisted of costs of second, third, and fourth mailings and phone solicitations. Another member estimates that for its last six open-end fund proxy campaigns, costs attributable to follow-up solicitations ranged from 41 to 58 percent.[16]

While the proxy process is challenging for large and small fund complexes alike, their experiences differ somewhat.

The dollar costs for larger fund complexes tend to be larger in absolute terms because of their larger numbers of shareholders. But for smaller complexes, the costs can be larger in relative terms because of the fixed costs involved (*e.g.*, legal costs in preparing proxy materials) and the inability to achieve certain economies of scale (*e.g.*, volume discounts for printing and mailing) when conducting proxy campaigns. To the extent that small funds bear these proxy expenses, this puts upward pressure on their expense ratios, which third parties and investors scrutinize in the highly competitive fund marketplace. Some small fund advisers instead bear these expenses (*e.g.*, pursuant to expense limitation arrangements, or on an *ad hoc* basis to constrain fund costs for competitive reasons). This is not an optimal use of an adviser's resources, and this dynamic may deter new entrants to the fund business.

Earlier this year, we were pleased to learn of the Division of Investment Management's outreach initiative targeted at small- and mid-sized fund sponsors, with its goal "to hear from these groups about regulatory barriers and to begin thinking about ways we could address them."[17] As part of this initiative,

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[15] We understand that advisers sometimes agree to assume costs in connection with certain proxy proposals (*e.g.*, fund reorganizations). And some funds are subject to expense limitation arrangements that could result in an adviser bearing some or all of these proxy costs, although some of these arrangements may exclude proxy costs from the limitation.

[16] Several fund-specific factors influence a fund's follow-up solicitation costs, including the type of proposal (and its quorum and passage requirements), its number of shareholders, and the relative make-up of its shareholder base (*e.g.*, institutional vs. retail, and NOBO vs. OBO).

[17] *Keynote Address: ICI Mutual Funds and Investment Management Conference*, Division of Investment Management Director Dalia Blass (Mar. 18, 2019), available at www.sec.gov/news/speech/speech-blass-031819.

we strongly encourage the SEC and its staff to consider how to reduce costs associated with the proxy system, which may disproportionately impact smaller fund complexes.

The realities of fund ownership and shareholder voting behavior described above have resulted in a costly and inefficient proxy system that is failing to serve the interests of funds and their shareholders. This is most apparent in the costs and burdens associated with follow-up solicitations, around which cottage industries have formed out of sheer regulatory necessity. When a fund does not achieve a quorum through its initial solicitation, the fund or its agent typically mails a second—and in some cases, a third and a fourth—set of printed proxy materials to those shareholders who have not responded. As with the initial printed distribution, shareholders typically ignore these subsequent distributions without acting, although a small percentage may respond.

Many funds rely on phone solicitations as a significant part of their proxy campaigns because of the limited response rates for paper mailings. This method also has several drawbacks, including shareholders' preferences. The transition away from landlines to cell phones also has made it harder for funds to reach their shareholders. While funds have greater latitude contacting shareholders on their landlines (*e.g.*, "robo-calling" is permissible), federal law and regulation generally prohibit funds from contacting shareholders through their cell phones (assuming they have this information) via regular calls or texts unless the shareholder previously has consented to that form of contact.[18]

Shareholders theoretically accessible by phone—this excludes OBOs and any NOBOs for whom funds do not have current phone numbers—often do not welcome this method of solicitation, for any number of understandable reasons, and most do not answer these calls. Those that answer commonly react with some combination of confusion, annoyance, deep suspicion, and/or anger, particularly given the increased prevalence of fraud and phishing schemes. But funds use phone campaigns because they are one of only two mass solicitation options and typically net at least some additional votes.

In short, the costs and difficulties associated with fund proxy campaigns are enormous and will not improve without regulatory intervention. We are encouraged that Commissioner Roisman recently recognized "the challenges that funds, as issuers themselves, face when they are required to seek shareholder proxies on certain matters, including the costs involved."[19] As the SEC reevaluates the proxy system generally, these challenges merit special attention, and the recommendations below deserve a central place in any reform package.

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[18] *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 to call or text wireless telephone numbers absent advance consent.

[19] *Remarks at SEC Speaks: Encouraging Smaller Entrants to Our Capital Markets*, Commissioner Elad L. Roisman (Apr. 8, 2019), available at www.sec.gov/news/speech/speech-roisman-040819.

II. Recommendations That Would Significantly Improve the Fund Proxy System

Below we recommend ways to reform the proxy system that would greatly benefit funds and their shareholders.

A. Modify Shareholder Approval Requirements Under the Investment Company Act

Multiple legal and regulatory provisions dictate the timing and frequency of shareholder meetings and shareholder approval requirements,[20] including the Investment Company Act. The Act requires the "vote of a majority of the outstanding voting securities of a company,"[21] to implement:

- Changes to fundamental investment policies;
- Investment advisory and principal underwriting agreements; and
- Certain distribution arrangements (so-called "Rule 12b-1" plans).[22]

Fund shareholders also periodically vote on nominees to the fund board.[23]

We strongly recommend that the SEC reevaluate these requirements. The SEC staff last did so over 25 years ago,[24] asking:

> "Do the benefits of statutorily required shareholder voting, both in the global sense and with respect to particular sections of the Act, outweigh its costs?"[25]

This remains a useful analytical framework. We submit that, in some instances, safeguards other than shareholder voting clearly would protect investors' interests at a lower cost. For instance, we see no

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

[21] 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."

[22] Investment Company Act Sections 13(a), 15(a) and (b), and Rule 12b-1(b)(1) thereunder, respectively. Rule 17a-8 (mergers of affiliated investment companies) also requires the merging fund's shareholders to approve the merger under this "majority vote" standard, unless the proposed transactions satisfies several conditions.

[23] Investment Company Act Section 16(a) 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* Investment Company Act 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.

[24] *Protecting Investors: A Half Century of Investment Company Regulation*, SEC Division of Investment Management, May 2002 ("1992 Report"), at 272-282, available at www.sec.gov/divisions/investment/guidance/icreg50-92.pdf.

[25] *Id.* at 274.

compelling policy reason to require shareholder approval of proposed changes to *all* policies that funds designate as "fundamental,"[26] particularly where they are not material to a fund's investment strategies or risks, the fund's board has approved the change, and shareholders receive advance notice of it.

We therefore recommend that the Commission consider replacing shareholder approval with the disclosure-oriented approach of Rule 35d-1 for changes to certain fundamental policies.[27] The 1992 Report recognized that not all changes to fundamental policies warranted shareholder approval, and it recommended eliminating shareholder approval of changes related to:

- "security-based loans" policies (encompassing use of repurchase agreements, lending of portfolio securities, and purchase of privately-offered debt securities); and
- concentration policies where the fund wishes to change from being "industry concentrated" to non-concentrated.[28]

Under Rule 35d-1, if a fund wishes to change the investment policy related to its name, the fund must provide its shareholders with at least 60 days prior notice of the change, and the rule requires that the notice be separate and prominent.[29] In addition, we recommend that such changes continue to be subject to board approval and amendment of the fund's registration statement. More generally, this

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[26] Section 13(a) of the Investment Company 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.

[27] Among other things, Rule 35d-1 permits a fund, subject to certain conditions, to change an investment policy tied to its name (*i.e.*, a policy to invest at least 80 percent of the fund's assets in investments, industries, countries, or regions suggested by the fund's name) without a shareholder vote if it is not a fundamental policy under Section 8(b)(3) of the Investment Company Act.

[28] 1992 Report at 279-282. With respect to security-based loans, the Report maintained that "[t]hese transactions generally have no more than a modest effect on an investment company's overall risk or return." With respect to concentration policies, the Report noted that such policies "may prevent an investment company's adviser from reallocating portfolio assets among industries in a way that best reflects its analysis of current market conditions, even if such action would pose little or no risk to shareholders."

[29] This notice must (i) be in plain English in a separate written document; (ii) state prominently, in bold-face type: "Important Notice Regarding Change in Investment Policy;" and (iii) include this same statement on the envelope in which the notice is delivered.

recommended approach would maintain shareholder protections, help rationalize treatment of investment policies under the Act,[30] and lower costs.[31]

We believe our recommendation fulfills the policy objective behind Section 13 of the Investment Company Act. While legislative history related to Section 13 is limited, the abuses it was intended to address appear to be funds making significant changes to their investment policies without shareholder approval *or* notice.[32] We believe that adequate advance notice of a fundamental policy change, coupled with existing redemption and sales rights, more than suffice to protect shareholders from significant and unannounced policy changes. Requiring shareholder approval in addition provides little investor benefit at great cost. And as noted above, changes to fundamental policies are not, in and of themselves, material to a fund's investment strategies and risks.

We also recommend that the SEC reconsider Section 15(a)'s shareholder approval requirement for sub-advisory agreements. The SEC provides "manager of managers" exemptive relief to fund complexes, which permits a complex with an order to enter into and materially amend sub-advisory agreements without shareholder approval, subject to numerous conditions. We are encouraged by recent developments in this area, and we believe that the SEC could build on this work for a proposed new rule.[33]

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[30] Assuming the SEC acts on this recommendation, any changes should carry through to Rule 17a-8, so that differences in those fundamental policies no longer requiring shareholder approval to change also would not trigger shareholder approval for affiliated mergers.

[31] We strongly disagree with the 1992 Report's assertion that "potential cost savings resulting from the elimination of shareholder voting would be significantly diminished by the continuing need to provide notice to shareholders of changes that are currently described in the proxy statement." While these costs are significant, they are generally predictable and manageable, unlike the costs associated with follow-up solicitations (*e.g.*, additional mailings and calling campaigns). *See supra*, page 5 for examples of members' estimated follow-up solicitation costs. Our members would be willing to incur the costs of these disclosure obligations—and indeed, would be willing to pair them with advance notice of the change in question—if they could shed the costs and challenges of solicitation.

[32] *See* Report Accompanying S. 4108 from the Senate Comm. on Banking and Currency, 76th Cong., 3d Sess. (Jun. 6, 1940) ("A major problem in the case of management companies is created by the absence of any legal requirement for adherence to any announced policies or purposes. Such policies have often been radically changed without the knowledge or prior consent of stockholders."); *see also* Alfred Jaretzki Jr., The Investment Company Act of 1940, 26 Wash. U. L. Q. 303, 317 (1941) ("There have been cases where investment companies substantially changed the nature and character of their business without stockholders' approval or, indeed, without any notice to stockholders and opportunity for objection.").

[33] *See Carillon Series Trust, et al.*, SEC Release Nos. IC-33464 (May 2, 2019) (notice) and IC-33494 (May 29, 2019) (order). In 2003, the SEC proposed, but never adopted, Rule 15a-5, which would have codified existing exemptive relief as of that time. *Exemption from Shareholder Approval for Certain Subadvisory Contracts*, SEC Release No. 33-8312 (Oct. 23, 2003), available at www.sec.gov/rules/proposed/33-8312.htm#P56_10387. The notice period following any new rule proposal would allow fund complexes to recommend further refinements to existing conditions for relief.

For matters requiring shareholder approval, we recommend that the SEC use its exemptive authority to create the following new way—to complement the existing two statutory ways—for a fund to satisfy the Act's "majority vote" requirement:

> 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 of achieving a "majority vote" with a requirement that a fund's board unanimously approve the proposed action.

For this purpose, "broker non-votes" would count for purposes of the quorum requirement and would *not* count for purposes of the affirmative vote calculation.[34] Shareholder votes affirmatively cast as "abstentions" would count for purposes of both quorum and the affirmative vote calculation, effectively acting as votes *against* the proposal.

To illustrate, suppose that:

- a fund has 100 shareholders, each with a one percent ownership interest in the fund; and
- in response to a proposal requiring a "majority vote" under the Act:
  - 28 shareholders affirmatively voted for it;
  - two affirmatively voted against it;
  - one abstained;
  - broker-dealers for four shareholders submitted proxy cards without voting instructions (*i.e.*, broker 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 $33^{1/3}$ percent quorum requirement; and
- by excluding the broker non-votes, the fund receives 90.3 percent support (28/31), exceeding the 75 percent affirmative vote requirement.

[34] We believe this approach is more appropriate because broker non-votes currently count as votes *against* an item requiring a "majority vote" under the Act. This effectively equates shareholder inaction with opposition. The better approach would be to exclude these non-votes for purposes of measuring shareholder support for a proposal.

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). 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).[35] Rather, it would provide a measure of relief in those instances where the Investment Company Act itself, without an obvious purpose, sets the bar higher than other applicable requirements and unnecessarily impedes funds' ability to seek and obtain shareholder approval in a reasonable and cost-effective way.

As always, shareholders have their right to "vote with their feet" in response to disfavored changes.[36] Further, scrutiny by intermediaries (through whom most shareholders purchase and hold fund shares), third-party analysts, gatekeepers, and others provides another check on funds—their negative assessments of fund actions can lead to heavy redemption activity.

B. Facilitate Funds' Ability to Communicate with Their Shareholders

As noted above, omnibus accounts have become so pervasive that it can be difficult, if not impossible, for funds to communicate directly with large numbers of their shareholders.[37] Trends in how shareholders prefer to communicate have exacerbated these difficulties, even when funds are able to identify and reach out to them. As a result, obtaining shareholder votes is quite challenging and expensive, for both legal and practical reasons.

We therefore recommend that the SEC make the solicitation process more efficient and less costly by allowing funds to deliver their proxy materials directly to their shareholders. The SEC could require intermediaries to maintain and provide lists of all fund shareholders and their delivery preferences to funds at a reasonable cost, solely for distributing fund proxy materials, irrespective of their status as an OBO or NOBO. Intermediaries already should have this information about their fund-owning clients, and generating this information upon a fund's request typically would not be difficult or costly. This

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

[36] The 1992 Report expressed some reservations with this rationale, surmising that fund shareholders would be reluctant to do so because of negative tax implications or incurrence of sales charges on a new fund investment. But much has changed since 1992. As of year-end 2001, 35 percent of mutual fund shares were held in retirement plans and IRAs (where investors can sell their fund shares without any adverse tax impact), and 38 percent of mutual fund assets were invested in share classes with front-end or deferred sales charges. As of year-end 2018, those figures were 46 and 12 percent, respectively. ETFs, which have no sales charges, were a negligible part of the investing landscape in 2002 (with $82 billion in assets as of the beginning of 2002), and had $3.4 trillion in assets as of year-end 2018. Thus, fund shareholders' redemption and sales disincentives have fallen significantly.

[37] *See supra*, pages 3 and 4, for a discussion of the SEC's OBO/NOBO rules and their practical effects on funds' proxy campaigns.

practical and fair suggestion would improve funds' ability to communicate directly to their shareholders and lower their proxy solicitation costs—a clear benefit for fund shareholders.[38]

III. Additional Recommendations for Improving the Fund Proxy System

This section includes additional recommendations that would improve shareholder engagement in the proxy process and lower costs.

A. Permit Funds to Include the Proxy Card with the Initial Proxy Notice under "Notice and Access"

In response to Chairman Clayton's concern regarding "this relatively low retail [proxy voting] participation rate,"[39] we recommend amending Exchange Act Rule 14a-16, the "notice and access rule." The rule explicitly prohibits the soliciting party from including a proxy card with the mailing of the initial notice of availability of proxy materials (the "Notice").[40]

We believe that allowing issuers to include a proxy card[41] in the same mailing with the Notice would improve shareholder voting participation, reduce costs, and encourage greater use of the notice and access model.[42] The current restriction on this practice:

- adds steps and friction to an already complex proxy solicitation and voting process;
- may confuse shareholders who are inclined to vote (as evidenced by reports of shareholders attempting to vote by returning a marked copy of a Notice); and
- inconveniences any shareholders prepared to vote shortly after receiving the first Notice.

Even with this change, shareholders still could access complete proxy materials online prior to casting their votes.

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[38] Funds could select their own vendor, negotiate a competitive price on behalf of fund shareholders, and then request a regulatory mailing list from the intermediary and provide it to the fund's selected vendor. *See* Processing Fee Letter, *supra* note 10, for additional information regarding how the SEC could accomplish this with respect to proxy and other regulatory materials.

[39] *See supra*, note 8.

[40] A proxy card may be included with a Notice if at least 10 days have passed since the date a Notice was first sent to shareholders.

[41] We use the term "proxy card" in this letter generally to include the "voting instruction form" (VIF) that beneficial owners receive from their intermediaries.

[42] The SEC's initial notice and access proposal would have allowed soliciting parties to include a proxy card with the Notice, but the SEC ultimately prohibited this based on some commentators' concerns that separating the proxy card from the proxy statement could lead to uninformed voting. The SEC's *Concept Release on the U.S. Proxy System* (Release No. 34-62495 (July 14, 2010), available at www.sec.gov/rules/concept/2010/34-62495.pdf) sought comment on possible further revisions to the "notice and access" model for distributing proxy materials.

Permitting inclusion of a proxy card with the required Notice would address these problems and would help increase voting rates. Currently, the prospect of decreased voter participation is a disincentive to utilizing the notice and access model. Lower voting rates may require funds to engage in additional solicitations to achieve a quorum, which entails substantial additional costs.

If the SEC addresses the NYSE fee schedule as we have recommended,[43] this change also would reduce costs, further inducing funds to use this model. It could encourage funds to use this method in a more targeted way (*e.g.*, funds may use it for those shareholders most likely to vote), thereby reducing mailing costs. Most obviously, having to make two mailings substantially reduces or possibly eliminates the cost savings that might otherwise be achieved through the notice and access model.[44]

B. Permit Greater Use of Layering, Linking, and Incorporation by Reference in Funds' Proxy Materials

We recommend that the SEC apply the disclosure principles underlying the summary prospectus to proxy statements. This would provide funds with the flexibility to provide their shareholders with printed materials more substantial than the current Notice, but considerably more succinct than today's proxy statement. Such a change would be most beneficial for combined proxy materials.

The SEC improved fund disclosure when it adopted the rule permitting mutual funds and ETFs to satisfy their prospectus delivery obligations using a short summary prospectus.[45] This recommended approach to proxy materials would be consistent with the summary prospectus rule, which allows for "a layered approach to disclosure in which key information is sent or given to the investor and more detailed information is provided online," with the intent of "provid[ing] investors with better ability to choose the amount and type of information to review… ." Recognizing the need for further improvements, the SEC's ongoing "investor experience" initiative has sought feedback on the delivery, design, and content of fund disclosures (including proxy statements) to learn how disclosure improvements could help investors make decisions.[46] ICI supports this initiative and has offered recommendations for improving fund disclosure generally.[47]

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[43] *See* Processing Fee Letter, *supra* note 10.

[44] While mailing a proxy card technically is optional, our members have indicated that doing so is a practical necessity to encourage sufficient voter response.

[45] *Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Companies*, SEC Release No. 33-8998 (Jan. 13, 2009), available at www.sec.gov/rules/final/2009/33-8998.pdf.

[46] *Request for Comment on Fund Retail Investor Experience and Disclosure*, SEC Release No. 33-10503 (June 5, 2018), available at www.sec.gov/rules/other/2018/33-10503.pdf.

[47] Letter from Susan Olson, General Counsel, ICI, to Brent J. Fields, Secretary, SEC (Oct. 24, 2018), available at www.sec.gov/comments/s7-12-18/s71218-4932121-178430.pdf.

Long term, we believe that the SEC should overhaul comprehensively the content of proxy materials in a manner that makes them more shareholder-friendly. Short term, the SEC could greatly reduce the length of proxy statements and still ensure that investors receive complete and easily accessible information by permitting greater use of layering, linking, and incorporation of information by reference[48] in proxy statements.

For instance, one member's 2017 combined proxy statement totaled 162 pages, almost half of which (77 pages) consisted of information about the funds' beneficial owners. The length of this disclosure was driven by the number of funds (and their related share classes) included in the proxy statement.[49] The SEC should permit funds to include a link to this information in the proxy statement and incorporate it by reference. Other prime candidates for a similarly streamlined disclosure approach include information about:

- the numbers of shares outstanding for each class of voting securities;
- fund officers;
- director ownership of fund shares;
- per-fund compensation to directors (in a combined statement, aggregated compensation figures should suffice, with a link to fund-specific information);
- independent auditors and the fees they receive (particularly where shareholders are not being asked to ratify their selection); and
- audit and nominating committee charters.

In each case, the information would remain available to shareholders online, and more critical information that pertains to the voting matters would remain in the proxy statement.

The Form N-14 registration statement is ripe for a similar overhaul. Fund reorganizations frequently require shareholder approval, and the current disclosure requirements result in shareholders receiving lengthy documents, sometimes running hundreds of pages. Form N-14 mandates extensive disclosure required by both the Form N-1A registration statement and the Schedule 14A proxy statement. In

[48] Schedule 14A permits incorporation by reference in proxy statements, but it comes with demanding delivery obligations. (*See* Note D.2 to Schedule 14A (requiring issuers to undertake to provide, without charge, to each person to whom a proxy statement is delivered, upon written or oral request, and by first class mail (or other equally prompt means) within one business day of receipt of such request, a copy of any and all information that has been incorporated by reference).) As a result, many funds forgo incorporation by reference, adding unnecessary complexity and costs to proxy statements by simply duplicating information already contained elsewhere. The SEC should streamline and modernize these incorporation by reference rules, in light of the ready electronic availability of this information.

[49] Issuers must disclose in their proxy statements information about the beneficial owners of more than 5 percent of any class of their voting securities. An operating company with a single class of voting shares will always have fewer than 20 such owners. By contrast, funds included in a combined proxy statement (particularly if they offer multiple share classes, as is common) could conceivably have thousands.

addition, Form N-14's incorporation by reference rules require that the acquiring fund's statutory prospectus accompany the combined prospectus and proxy statement.

The combined effect of the disclosure requirements of Form N-14, Form N-1A, and Schedule 14A, and the regulatory requirement to mail paper copies of the documents,[50] results in fund shareholders receiving bulky mailings. Streamlining required disclosure could result in significant cost savings to shareholders by reducing the expenses related to drafting, preparation, printing, and mailing. More importantly, such changes would increase the likelihood that shareholders would review the streamlined disclosures and cast votes.

Proxy statements ought to be engaging. In practice, their sheer bulk conspires against shareholder participation in the proxy process and generates enormous cost.

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[50] *See, e.g.* Form N-14, General Instruction G—Incorporation by Reference and Delivery of Prospectuses or Reports Filed with the Commission.

The Commission has the opportunity to act prudently to improve disclosure to heighten shareholder engagement, and to lessen the number of costly solicitations and adjournments, which ultimately will save fund shareholders millions of dollars.

ICI strongly supports the SEC's examination of the proxy system for funds and their shareholders. We stand ready to assist you in any manner to complete this important endeavor. If you have any questions, please contact me at [redacted], Susan Olson at [redacted], Dorothy Donohue at [redacted], or Matthew Thornton at [redacted].

Sincerely,

Paul Schott Stevens
President and CEO
Investment Company Institute

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

Dalia Blass, Director
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