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April 20, 2015

Mr. Brent J. Fields
Secretary
US Securities and Exchange Commission
100 F St, NE
Washington, DC 20549

Re: *Proposal to Require Disclosure of Hedging by Employees, Officers, and Directors (File No. S7-01-15)*

Dear Mr. Fields:

The Investment Company Institute (“ICI”)¹ appreciates the opportunity to comment on the proposal by the Securities and Exchange Commission (“SEC” or “Commission”) regarding the disclosure of hedging by employees and directors.² The proposal would implement Section 955 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”). This provision, which adds new Section 14(j) to the Securities Exchange Act of 1934 (“Exchange Act”), directs the SEC to adopt rules requiring a company to disclose whether it allows any employee or director to purchase financial instruments, including derivatives, designed to hedge or offset any decrease in the market value of equity securities (i) granted to the employee or director by the company as compensation or (ii) held directly or indirectly by the employee or director.

ICI supports the Commission’s determination to exclude most registered investment companies from the proposed disclosure requirements for the reasons discussed in the Proposal. We recommend, however, that the Commission also exclude listed closed-end funds from any final disclosure requirements for the reasons discussed below.

¹ The Investment Company Institute (ICI) is a leading, global association of regulated funds, 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 U.S. fund members manage total assets of \$18.1 trillion and serve more than 90 million U.S. shareholders.

² *Disclosure of Hedging by Employees, Officers and Directors*, 80 FR 8486 (Feb. 17, 2015), available at <http://www.gpo.gov/fdsys/pkg/FR-2015-02-17/pdf/2015-02948.pdf> (“Proposal”).

I. Concerns Intended to be Addressed by Dodd Frank Act Do Not Apply to Closed-End Funds

As discussed in the Proposal, in enacting Section 955 of the Dodd-Frank Act, Congress intended to “allow shareholders to know if executives are allowed to purchase financial instruments to effectively avoid compensation restrictions that they hold stock long-term, so that they will receive their compensation even in the case that their firm does not perform.”³ This concern that the hedging activities would allow employees or directors to receive (and benefit from) incentive-based compensation despite a decline in the company’s performance arose in the context of operating companies.⁴ Neither the legislative history nor commentary at the time of the legislation indicates that the purpose of the legislation was to address abuses with respect to closed-end funds.

We are concerned, therefore, that the Proposal by sweeping in listed closed-end funds⁵ goes beyond effectuating Congressional intent. Moreover, in determining to extend the Proposal to closed-end funds, the Commission has not demonstrated that closed-end fund executives engage in the problematic hedging practices employed by operating company executives. In fact, we believe that most closed-end funds do not compensate their employees and directors through closed-end fund shares. Given that the Dodd-Frank Act provision was not intended to address concerns with respect to executives of closed-end funds and the lack of evidence of a problem in this area for closed-end funds, we agree with Commissioners Gallagher and Piowar that the disclosure requirement should not apply to listed closed-end funds.⁶

II. Structure of Closed-End Fund (Like Other Funds) Alleviates the Need for Disclosure

Closed-end funds, similar to other types of registered funds, typically are externally managed and do not employ executives or have employees like operating companies. Rather, a closed-end fund’s investment adviser generally employs and compensates employees that provide all the necessary services to the fund. As the Commission stated in the Proposal, open-end funds, exchange-traded funds (“ETFs”), and unit investment trusts (“UITs”) are distinct from operating companies in several

³ Proposal, *supra* note 2, at 8487.

⁴ See Carr Bettis, John Bizjak, and Swaminathan Kalpathy, *Insiders’ Use of Hedging Instruments: An Empirical Examination* (March 2009), available at http://www.shareholderforum.com/sop/Library/20090318_Bettis-Bizjak-Kalpathy.pdf.

⁵ “Listed” closed-end funds are closed-end funds that have shares that are listed and registered on a national securities exchange.

⁶ Commissioners Gallagher and Piowar in a joint statement on the Proposal stated that they would not have included listed closed-end funds within the scope of the rule. See Commissioners Daniel M. Gallagher and Michael S. Piowar, Joint Statement on the Commission’s Proposed Rule on Hedging Disclosures (Feb. 9, 2015), available at <http://www.sec.gov/news/statement/020912ps-cdmg-cmsp.html#.VN0PaChnCg0>.

relevant respects. ICI agrees with the Commission's assessment⁷ and supports the Commission's determination to exclude open-end funds, ETFs, and UITs from the disclosure requirements. We submit, however, that for the purposes of executive compensation disclosure and the concerns related to hedging activities, listed closed-end funds exhibit the same characteristics as other funds and should be treated the same as other funds.⁸

The Commission has reached similar conclusions in the context of executive compensation rules by not requiring closed-end funds to disclose certain information related to executive compensation and registrant performance under Item 402 of Regulation S-K, as is required for operating companies.⁹ The Commission predicated the 1992 Executive Compensation Rule on fulfilling the regulatory objective of providing shareholders with additional information regarding compensation and the potential incentives that various compensation structures can create and specifically exempts *all* registered investment companies (including closed-end funds).

We agree with the Commission that transparency for shareholders and strengthening corporate governance generally benefit shareholders. ICI believes, however, that the characteristics of listed closed-end funds are more similar to the features of other types of funds, and, therefore, should not be made subject to the new proposed disclosure requirements.¹⁰ The Commission's goals underlying the Proposal, as well as consistency regarding executive compensation disclosure, would be best achieved by retaining the disclosure requirement in the Statement of Additional Information and the annual proxy statement without imposing an additional proxy statement disclosure requirement.

⁷ The Proposal cites various differentiations that include (i) the external management structure for funds, (ii) the limited number of employees who are compensated by the fund, and (iii) fund compensation practices. *See* Proposal, *supra* note 2, at 8493.

⁸ The Commission has previously noted that both open-end and closed-end registered investment companies are subject to an already "pervasive system of federal regulation in certain areas of corporate governance." *See Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing of Proposed Rule Change to Modify the Listing Rules for Compensation Committees To Comply with Rule 10C-1 under the Exchange Act and Make Other Related Changes*, Release No. 34-68013 (Oct. 9, 2012).

⁹ *See Executive Compensation Disclosure*, 57 FR 48126 (Oct. 16, 1992) ("1992 Executive Compensation Rule"). In the adopted rules, the Commission explicitly excluded registered investment companies from the executive compensation disclosure requirements of revised Item 402 "because the management functions of most such companies are performed by external managers. Instead, registered investment companies will comply with disclosure requirements prescribed by applicable Investment Company Act registration statements." Closed-end funds accordingly disclose compensation paid to directors and their ownership in the fund in their statement of additional information and annual proxy statements.

¹⁰ For example, we agree with the Commission's analysis that "[c]oncerns about avoiding restrictions on long-term compensation, which we understand to be one of the reasons Congress mandated this disclosure, may therefore be less likely to be raised with respect to funds." Proposal, *supra* note 2, at 8493.

In addition, the structure of a fund provides transparency of the “value” of the company to shareholders. Although a listed closed-end fund trades at negotiated market prices on a national securities exchange, the assets of a fund consist of investment securities. Shareholders receive audited annual and unaudited semiannual reports within 60 days after the end and the midpoint of the fund’s fiscal year. These reports contain, among other things, updated financial statements and a list of the fund’s portfolio securities.¹¹ After the first and third quarter, funds also file Form N-Q disclosing the complete schedule of their portfolio holdings. Closed-end funds also typically publish their net asset value (“NAV”) daily or weekly. Moreover, because of restrictions on leverage and capital structure imposed by the Investment Company Act of 1940, the compensation of directors and employees generally cannot be structured in a way that would incentivize them to take undue risks that they would need to hedge. Therefore, given the transparent nature of funds and their unique structure, we do not believe they pose the same risk “profile” as operating companies and there is less likely to be a misalignment of compensation practices and actual executive hedging activities. Accordingly, we believe that unlike operating companies, closed-end funds do not create the same concerns as operating companies.

III. Costs of Compliance and Implementation of Policies on Hedging Will Outweigh the Benefits

The proposed requirements to include certain disclosures in any proxy or consent solicitation materials and information statements with respect to the election of directors would place additional expenses on closed-end funds. We understand that most closed-end funds do not have specific policies regarding whether employees and directors are permitted to hedge their shares of closed-end funds nor do they have policies that specify permissible and prohibited categories of hedging transactions. Therefore, to comply with this new requirement, closed-end funds would have to expend resources to develop, revise, and maintain such policies – costs of which will ultimately be borne by fund shareholders. Moreover, these funds would be required to implement a system to collect and report the information in connection with their hedging policies. Given that there has been no demonstrated concerns in this area for closed-end funds (and therefore potentially limited value in providing this disclosure), we do not believe that the benefits of imposing the disclosure obligation outweigh the costs.

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ICI appreciates and supports the goal of new Section 14(j) of the Exchange Act to provide investors with greater knowledge regarding the hedging activities of employees and directors of operating companies. We support the Commission’s decision to exclude open-end funds, ETFs, and

¹¹ A fund is permitted to include a summary portfolio schedule in its shareholder reports in lieu of the complete schedule, provided that the complete portfolio schedule is filed with the SEC and is provided to shareholders upon request, free of charge. The summary portfolio schedule includes each of the fund’s 50 largest holdings in unaffiliated issuers and each investment that exceeds one percent of the fund’s NAV.

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UITs from the disclosure requirements and recommend that the Commission similarly exclude closed-end funds from the disclosure requirements. If you have any questions on our comment letter, please feel free to contact me at [REDACTED] or Jennifer Choi at [REDACTED].

Sincerely,

/s/ Dorothy Donohue

Dorothy Donohue
Deputy General Counsel – Securities
Regulation

cc: The Honorable Mary Jo White
The Honorable Luis A. Aguilar
The Honorable Daniel M. Gallagher
The Honorable Kara M. Stein
The Honorable Michael S. Piwowar