August 13, 2009

VIA E-MAIL: rule-comments@sec.gov
Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Facilitating Shareholder Director Nominations, File No. S7-10-09

Dear Ms. Murphy:

I appreciate this opportunity to comment on the proposed rule Facilitating Shareholder Director Nominations (the "Proposed Rule"). I am member of the Isenberg School of Management faculty at the University of Massachusetts, Amherst. Prior to joining academia, I was an Associate General Counsel at Fidelity Investments. My current research focuses on the intersection of mutual funds (and other collective investment pools) and corporate governance. I fully support this Proposed Rule as applied to all companies subject to the Exchange Act proxy rules, however, this letter shall focus solely on mutual funds as issuers.

I. Mutual Funds as Issuers Should be Covered by the Rule Facilitating Shareholder Director Nominations

Upon reviewing the Proposed Rule, I was encouraged to learn that mutual funds, as issuers, are within the intended scope. However, much can change between initial proposal and final rule. Thus, I write to say, in short, **please do not exempt mutual funds from the obligations to give fund shareholders proxy access for director nominations**. Those who are critical of the Investment Company Act's "shareholder voting requirements view voting as a superfluous exercise.[1] However, the Commission has consistently supported fund shareholder voting as part of the Act's "comprehensive framework predicated upon principles of corporate democracy."[2]

Mutual funds are an important intermediary, channeling investor assets to the capital markets. As of June 2009, U.S. mutual fund assets stood at approximately $10 trillion. More than 90 million Americans are invested in mutual funds[3] and over 77 million of them (half of all US households) are invested in stocks through equity mutual funds.[4] Nearly 20% of household financial assets are managed by registered investment companies.[5] If investors in an equity fund are dissatisfied with the activities of the underlying portfolio companies held by their funds, they have limited avenues of recourse. They can rely upon the mutual fund adviser ("fund adviser") or the board to act for them. However, this important avenue is not sufficient as data suggest that the most popular

[1] DIV. OF INV. MGMT., U.S. SEC & EXCH. COMM'N, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 272 (1992), available at http://www.sec.gov/divisions/investment/guidance/icreg50-92.pdf
[2] Id. at 252.
[3] Investment Company Institute, Trends in Mutual Fund investing, available at http://www.ici.org/research/stats/trends/trends_06_09
[4] INV. CO. INST. & SEC. INDUST. ASS'N, EQUITY OWNERSHIP IN AMERICA 44 (2005).
[5] INV. CO. INST., 2009 INVESTMENT COMPANY FACT BOOK, available at http://www.ici.org/pdf/2009_factbook.pdf

mainstream fund advisers have placed their interest in asset gathering ahead of their fiduciary duty to act on behalf of investors.[6]

Thus, fund shareholders must also have the right to use the proxy machinery to nominate board members in accordance with the Rule Proposal. Data show that even a small number of dissident board members can make a big difference.[7] This Proposed Rule will add competition to the board nomination process. This, in turn may increase board dependency upon fund shareholders and create some traction in board negotiations with fund advisers over fees, expenses and other related matters. Given that boards are loathe to use the "nuclear option" and fire the fund adviser, gaining bargaining power to negotiate more strongly on behalf of fund investors is essential.

II. The Special Exception to the Change to NYSE Rule 452 for Mutual Funds is Not Applicable

Recently, mutual funds as issuers were not included in the change to New York Stock Exchange Rule 452.[8] The rule change ended the previously permissible practice of broker discretionary voting in uncontested director elections on behalf of stock owners who failed to vote or provide instructions. However, mutual fund advisers are still permitted to count in non-contested director elections, non-votes as both present for the purpose of establishing a quorum and "pro" management if the brokerage firm that holds the shares votes for management's recommendations.

While this exception was made in the case of discretionary voting for director elections, it does not follow that mutual funds must also be excluded from providing proxy access. The reasons upon which the 452 exclusion were based are not dispositive here. Accordingly, I hope that the Commission would consider this Proposed Rule separately and resist suggestions that mutual funds should be exempted.

Objections to applying the Proposed Rule to mutual funds might fall into two categories. Argument one might be that this new rule would be too costly. Argument two might be that it is futile in the effort to increase shareholder rights. However, these contentions do not hold up to logic for the following reasons.

III. Arguments About Unreasonable Additional Costs Do Not Apply

When objecting to eliminating broker voting in routine matters for silent fund shareholders, the fund industry argued that failure to allow broker voting would result in added costs – to pay outside proxy vote solicitation service to achieve a quorum.[9] This level of incremental costs would not exist with the Proposed Rule for the following reasons. The fund industry has argued that because retail mutual fund shareholders hold a greater percentage of fund shares (than do retail investors of operating companies)[10] and are less likely to vote, it is difficult establish a quorum. This leads to delays and to added costs.

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[6] See generally, Jennifer S. Taub, "Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholder's Rights, *Journal of Corporation Law* Vol. 34, Issue 3 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1066831

[7] See, Gretchen Morgenson, "Elect a Dissident and You May Win a Prize," New York Times, May 23, 2009 (referencing a study conducted by the Investor Responsibility Research Center Institute and Proxy Governance).

[8] See http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf

[9] See Investment Company Institute Comment Letter, available at http://www.ici.org/policy/comments/09_sec_rule452_com

[10] Id (The ICI letter notes that as of December 2007, "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.")

Based upon this assertion, these passive retail shareholders would not likely collectively act to reach the ownership threshold to nominate a director. Accordingly, extremely rarely would there be a contested election initiated by retail investors. Thus, most director elections would allow for discretionary voting. It would be the rare director election that would be "non-routine." Thus these extra costs would not be incurred.

Similarly, as report by the Commission in the proposing release:

> "the business community and many of its legal advisors have expressed concern that mandating shareholder access to company proxy materials could turn every election of directors into a contest, which would be costly and disruptive to companies and could discourage some qualified board candidates from agreeing to appear on a company's slate of nominees."[11]

However, as noted above, this feared event of "every election" being contested, seems unlikely to materialize at mutual funds, given the notorious passivity of retail investors in mutual funds.

IV. Arguments Concerning Futility Are Too Early or Illogical

The second argument, that this Proposed Rule is futile, also falls flat. Institutional shareholders of mutual funds (such as retirement plans) vote their proxies. In addition, retail shareholders are beginning to become active in the mutual fund proxy space. If the industry is wrong in its past assertions about retail shareholder passivity, then if such a situation arises where retail investors are (or an institutional investor is) so displeased with either the fund advisor or the board, having this Proposed Rule in place would be particularly useful. This type of non-routine, contested election might not even require extra fees for outside solicitors, and if so, would be the sort that might provide a benefit that outweighs the cost, particularly if objections to existing management related to fees or expenses. And, if this becomes common, then it shows that empowering shareholders was a worthwhile pursuit. Thus, if the Proposed rule is "futile" due to passivity of investors, it is cost-free. If it is not cost-free, it will not have been futile.

In addition, if mutual fund advisers were interested in hearing more regularly from shareholders or empowering shareholders they would hold annual meetings. They might do so in single annual meeting for the entire fund family or by holding the meetings over the same week each year. This would be less confusing and more efficient for both fund shareholders and fund advisers. If this is good enough for the fund board of directors who can oversee a hundred or more funds in a single monthly board meeting, it should be fine for investors. This would minimize costs and confusion all around.

This proposal for a fund family annual meeting would be a departure from current practices. While mutual funds have boards of trustees or directors, that are elected by shareholders, there is no requirement under the state laws where most are established, of an annual meeting. Thus meetings are on irregular schedules and only held either when shareholder approval is required. Moreover, if fund advisers wished to get investors more active, they might draw upon the online marketing techniques that have been successful in the past to drive business to a variety of funds or investment opportunities.

One reason that mutual fund retail investors don't vote is due to the infrequency and lack of predictability of shareholder meetings. A second reason is that the actual proxy mailings are very confusing. The names of the mutual fund trusts that appear on the mailings are different from the "brand name" mutual fund in which they

[11] Available at http://www.sec.gov/rules/proposed/2009/33-9046fr.pdf

invest. Third, as with all voting for directors, when there is the same number of nominees as there are open seats, ones vote is meaningless. The mutual fund adviser's slate will be elected. Fourth, most mutual fund investors own shares through a 401(k) plan. For these shares, the investor is not considered an owner and thus will not receive proxy materials. These shares are to be voted by the plan trustee, not the underlying investor/participant. Thus, it can be confusing to a mutual fund investor as to what does and does not require participation and attention.

Moreover, shareholder activism is a dynamic process. With the change to Rule 452, law firms providing advice to operating companies are suggesting that management begin to educate shareholders on voting. Additionally, with recent government intervention and bailouts of major firms, the public is growing more aware of shareholder rights issues. Evidence from recent annual meetings demonstrates the success of well-organized investors to make governance changes.[12]

This trend of investor education and activism is beginning to arrive in the mutual fund sphere. This is occurring just as retail fund investors are beginning to actively use the proxy machinery to express ownership rights. For example, the group Investors Against Genocide has introduced shareholder resolutions at mutual fund families and gained ballot access. Notwithstanding the traditional passivity of mutual fund investors, the Investors Against Genocide proposal received more than 31% at one fund family.[13] These efforts do not appear to be welcomed by fund advisers. Indeed, recent anecdotal evidence suggests that some proxy solicitors may have pressured or delayed fund investors who have chosen to vote against the board's recommendation.[14]

V. Conclusions

In conclusion, I commend the Commission for this proposal to strengthen the ability of shareholders to nominate directors and sincerely hope that mutual funds remain within the scope of the final rule. Arguments that this will be too costly or futile are mutually exclusive. If this is futile, it will not be costly. If it costs a bit more, it will not have been futile. Moreover, industry arguments that shareholder passivity is a static, inflexible fact should not be taken lightly as a "free pass" to avoid investor protection. Instead, perhaps we might look more closely at the problem and assist the industry at arriving at solutions, such as a fund-family wide annual meeting or similar suggestions for making theoretical shareholder rights a reality.

Respectfully Submitted,

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[12] See e.g. Dan Fitzpatrick & Marshall Eckblad, "Lewis Ousted as BofA Chairman: Stays as CEO as Shareholders Vote to Split Top Jobs in Wake of Troubled Merrill Merger," *Wall Street Journal*, April 30, 2009.

[13] See Investors Against Genocide website at http://investorsagainstgenocide.net/

[14] See, e.g. David Weidner, *Blood for Cash: Commentary: Fidelity Vote Reflects Changing Momentum*, MARKETWATCH, April 8, 2008, available at http://www.marketwatch.com/story/mutual-funds-have-blood-on-their-hands