



1401 H Street, NW, Washington, DC 20005-2148, USA  
202/326-5800 www.ici.org

April 28, 2011

Elizabeth M. Murphy  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: *Listings Standards for Compensation Committees (File No. S7-13-11)*

Dear Ms. Murphy:

The Investment Company Institute<sup>1</sup> is pleased to comment on the Securities and Exchange Commission's proposal regarding compensation committees of listed companies.<sup>2</sup> The proposal would implement Section 952 of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*. This provision, which added Section 10C to the Securities Exchange Act of 1934, requires the Commission to adopt rules directing the national securities exchanges to prohibit the listing of any equity security of a company that is not in compliance with Section 10C. According to the Release, in enacting Section 10C, Congress intended to require that board committees that set compensation policy consist only of independent directors and to provide shareholders of public companies with additional disclosure involving compensation practices.

As significant investors in U.S. public companies, investment companies fully recognize the important role that independent compensation committees play. We believe the Commission's proposal will strengthen compensation committees at operating companies, and we fully support it in that regard. The very concept of compensation committees, however, is wholly inapplicable to the vast majority of investment companies, because they do not have compensated executives and, accordingly, do not have compensation committees. Given this fundamental structural and regulatory difference

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<sup>1</sup> The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds ("ETFs"), and unit investment trusts ("UITs"). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of the ICI manage total assets of 13.0 trillion and serve over 90 million shareholders.

<sup>2</sup> SEC Release Nos. 33-9199; 34-64149, dated March 30, 2011, which is available at <http://www.sec.gov/rules/proposed/2011/33-9199.pdf> ("Release").

from operating companies, which is described in greater detail below, the Commission should exempt registered investment companies from the entirety of Rule 10C-1.

We support the Commission's decision to exclude investment companies from the proposed disclosure requirements regarding compensation consultants, recognizing that investment companies already have distinct proxy disclosure requirements tailored to their operations.

## I. Applicability of Proposal to Investment Companies

The proposal would apply to *all* listed companies, including closed-end investment companies and exchange-traded funds.<sup>3</sup> We are pleased that the Commission recognized that in implementing these proposals, it may be appropriate to exclude investment companies.<sup>4</sup> We strongly recommend that the Commission exempt all registered investment companies from Rule 10C-1 in view of the fundamental differences between investment companies and other listed companies and the existence of regulatory requirements for investment companies that satisfy the policy goals underlying the proposed rule.

The structure and operation of investment companies are vastly different from the operating companies that the proposal seems intended to address. Most investment companies are externally managed – that is, they have a contract with an investment adviser that manages the fund's securities portfolio in conformance with the fund's stated investment objectives and policies. As a result, these investment companies do not have compensated executives and, therefore, do not need compensation committees to oversee executive compensation.

In addition, the Investment Company Act has requirements that are tailored to focus the attention of investment company independent directors on potential conflicts of interest related to investment adviser compensation. Specifically, Section 15(a) makes it unlawful for any person to serve as an investment adviser except pursuant to a written contract that has been approved initially by a majority of the investment company's shareholders. Section 15(a)(2) further provides that an advisory contract can run initially for a period of no more than two years, and continue in effect thereafter only if the board annually approves it. In addition, Section 15(c) requires the advisory contract and any

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<sup>3</sup> Rule 10C-1(b)(iii)(4) differentiates investment companies in one respect by carving out “open-end management investment companies registered under the Investment Company Act of 1940” from the independence requirements that otherwise would be applicable to compensation committee members.

<sup>4</sup> The Release states that compensation committees generally are used by operating companies and requests comment on whether the Commission should exempt registered investment companies from some or all of the requirements of Section 10C. The Release also specifically notes that registered investment companies are exempt from current exchange listing standards that require listed issuers to either have a compensation committee or to have independent directors determine, recommend, or oversee specified executive compensation matters.

renewal thereof be approved by a majority of the independent directors. This action must take place at a meeting called for the purpose of voting on such approval and the votes must be cast in person. An investment company's independent directors typically meet outside the presence of management representatives to discuss the advisory contract.<sup>5</sup> Moreover, investment companies are required to disclose in their shareholder reports the factors the board considered in approving and reviewing the advisory contract.<sup>6</sup> Finally, Section 36(b) of the Act imposes, as a matter of federal law, a fiduciary duty on an investment company's investment adviser with respect to the amount of compensation received from the company.<sup>7</sup>

The Commission recognized in the Release that all registered investment companies are exempt from *current* exchange listing standards relating to compensation committees. The New York Stock Exchange previously determined to exempt these investment companies from the compensation committee requirements, stating that they were "unnecessary for closed-end and open-end management investment companies given the pervasive federal regulation applicable to them."<sup>8</sup> In approving the NYSE's listing standards, the Commission agreed with the NYSE's assessment, stating that the exemptions for investment companies from new requirements relating to the role of independent directors in compensation decisions, "is reasonable, because the Investment Company Act already assigns important duties of investment company governance, such as approval of the investment advisory contract to independent directors."<sup>9</sup>

Given this background, we strongly recommend that the Commission exempt registered investment companies from Rule 10C-1. Doing so has the dual benefits of providing regulatory certainty for investment companies regarding their need to comply with compensation committee

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<sup>5</sup> Investment Company Act Rule 0-1(a)(7)(vi) requires independent directors to meet at least quarterly in a session at which no directors who are interested persons of the investment company are present. While not specifically required, discussing the advisory contract in such a session is long-standing industry practice. *See, e.g., Investment Company Institute: Report of the Advisory Group on Best Practices for Fund Directors: Enhancing a Culture of Independence and Effectiveness* (June 24, 1999) ("Best Practices Report") at 24.

<sup>6</sup> Item 27(d)(6) of Form N-1A; Instruction 6(e) of Item 24 of Form N-2.

<sup>7</sup> The standards guiding the process of approving the advisory contract are complex. The Supreme Court recently endorsed the well tested legal framework articulated in *Gartenberg v. Merrill Lynch Asset Management, Inc.* 694 F. 2d 923 (2d Cir. 1982) cert. denied, 461 U.S. 906 (1983). *See Jones et al. v. Harris Associates L.P.*, No. 08-586 (March 30, 2010).

<sup>8</sup> See NYSE Listed Company Manual Section 303A.00. See also Nasdaq Rule 5615(a); NYSE Arca Rule 5.3; NYSE AMEX LLC Company Guide Section 801.

<sup>9</sup> See SEC Release No. 34-48745 at p. 45 (November 4, 2003), available at <http://www.sec.gov/rules/sro/34-48745.htm>.

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requirements and permitting the exchanges to devote their resources to reviewing their compensation committee requirements for operating companies.<sup>10</sup>

## II. Compensation Consultant Disclosure

Section 10C(c)(2) of the Exchange Act requires that, in any proxy solicitation for an annual or special shareholder meeting, each issuer must disclose, in accordance with Commission regulations: (1) whether the compensation committee has retained or obtained the advice of a compensation consultant; and (2) whether the work of the compensation consultant has raised any conflict of interest and, if so, the nature of the conflict and how the conflict is being addressed. Item 407 of Regulation S-K currently requires most Exchange Act registrants that are subject to the proxy rules to provide certain disclosures concerning their compensation committees and the use of compensation consultants. As the Commission pointed out in the Release, registered investment companies are subject to distinct proxy disclosure requirements, which do not include the compensation committee disclosure described in Item 407(e) of Regulation S-K. Consistent with current regulations, under the proposal, registered investment companies would not be required to provide disclosure regarding compensation advisers. We support the proposed approach and urge the Commission to incorporate it in any final rules.

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We appreciate the Commission's consideration of our comments. If you have any questions or need additional information, please contact me at (202) 218-3563.

Sincerely,

/s/

Dorothy M. Donohue  
Senior Associate Counsel

cc: John Carey, Chief Counsel, NYSE Regulation, Inc.  
Susan Nash, Associate Director, Division of Investment Management

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<sup>10</sup> It also avoids the potential for different exchanges implementing somewhat different rules for investment companies. A piecemeal approach would impose regulatory burdens on investment companies without providing any corresponding benefit to investment company investors.