

February 13, 2006

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

Re: Internet Availability of Proxy Materials;
File No. S7-10-05

Dear Ms. Morris:

The Investment Company Institute¹ strongly supports the Commission's proposal to permit issuers, including investment companies, to make greater use of the Internet to furnish proxy materials to shareholders.² The proposed "notice and access" model is an important step in the Commission's ongoing efforts to take advantage of the Internet and other technological advances to help serve investors' information needs.

Greater ability to rely on the Internet as a disclosure vehicle is highly appropriate, given the explosive growth in the use of the Internet and its importance to investors as an information source. The Proposing Release indicates that up to 75% of Americans have access to the Internet in their homes, and that this percentage is increasing steadily among all age groups.

The case is even stronger for mutual fund investors. A recent Institute study found that nearly 90 percent of fund investors have access to the Internet at work, or at home, or both.³ The study found that fund investors who go online are more likely than other Internet users to access their financial and investment accounts, and that almost 60 percent of fund investors who use the Internet do so to obtain investment information.

¹ The Investment Company Institute is the national association of the U.S. investment company industry. More information about the Institute is available at the end of this letter.

² SEC Release Nos. 34-52929; IC-27182 (Dec. 8, 2005), 70 Fed. Reg. 74598 (Dec. 15, 2005) ("Proposing Release").

³ Investment Company Institute, "Mutual Fund Shareholders' Use of the Internet, 2005," *Fundamentals*, Vol. 15, No. 2, February 2006. Institute President Paul Stevens will discuss the study in a speech on using the Internet to help meet investors' information needs, to be delivered at the National Press Club in Washington, D.C. on February 14, 2006. The study will be available on the Institute's website, www.ici.org, that afternoon.

With such widespread use of the Internet by fund investors, the time has come for the Commission to further expand the ability of funds to use the Internet for disclosure purposes. The Internet provides a unique tool for improving the quality of mutual fund disclosure while meeting a variety of needs and preferences for different levels of information. Chairman Cox has made clear his interest in using technology to improve investor disclosure, including fund disclosure.⁴ The Institute urges the Commission to pursue this goal as part of a top-to-bottom review of the mutual fund disclosure regime. We look forward to working with the Commission and the staff on this important initiative.

With respect to the proposal, investment companies have an interest in the “notice and access” approach for proxy materials both as investors that vote proxies and as issuers of voting securities. Our comments focus on the proposal’s application to investment companies as issuers. Our principal comments are as follows:

- The Commission should permit the use of the “notice and access” model for proxy materials for business combinations and for investment company shareholder reports. The proposed delivery method is fully appropriate for these items.
- The Commission should expand the time period for responding to shareholder requests for paper copies of the proxy materials from two business days to three business days after the requests are received. In addition, if an issuer sends the Notice of Internet Availability of Proxy Materials (“Notice”) more than 30 days before the shareholder meeting, the issuer should be permitted to aggregate requests for paper copies and respond to them as a group by no later than 30 days before the meeting.
- The Commission should permit issuers to include in or with the Notice impartial explanatory information designed to help shareholders understand the significance of the proxy solicitation and to anticipate general questions shareholders may have about the proxy proposals and voting mechanics. This type of information may attract the interest of shareholders more effectively than the Notice on its own, and could promote greater participation in proxy voting.
- The Institute supports the proposal to require intermediaries to follow the “notice and access” delivery method if the issuer decides to do so. Otherwise, the benefits of the proposal for funds and their shareholders could be significantly diminished. We further recommend that intermediaries be permitted to use the “notice and access” model for their customers, even if the issuer chooses not to use it.
- The Commission should establish eligibility standards for shareholders to conduct electronic-only solicitations and require them to send a Notice to the holders of a majority of the investment company’s voting securities. These requirements are

⁴ See, e.g., Remarks Before the Economic Club by Chairman Christopher Cox, U.S. Securities and Exchange Commission (Dec. 12, 2005).

intended to ensure that electronic-only proxy solicitations by shareholders are *bona fide* solicitations.

These and our other comments are discussed in detail below.

Scope of the Proposal

The Institute recommends that the Commission reconsider its decision not to permit the use of the “notice and access” model for (1) proxy materials for business combinations and (2) investment company shareholder reports. The proposed exclusion of these items suggests that the Commission has not fully embraced the “notice and access” model. As discussed below, we believe that the anticipated benefits of the proposal are fully appropriate for proxy materials related to business combinations and for investment company shareholder reports.

Business Combinations

The Commission should revise the proposal to extend it to proxy materials for business combinations. In issuing the proposal, the Commission already has determined that the “notice and access” model is a valid and meritorious method of delivering important disclosure to investors. Having made this policy decision, the Commission should apply it in a consistent manner.

The Proposing Release notes that business combinations typically involve proxy statements of considerable length and complexity. In the Institute’s view, this fact argues strongly in favor of extending the notice and access proposal to these transactions. The Commission’s initiative is based on the premise that investors will find it helpful to review materials that are long and complex in a format that is searchable and easy to navigate. In his opening statement at the Commission’s meeting on the proposal, Chairman Cox highlighted the usefulness of searching proxy statements online, observing that: “Not only is a manual search of often lengthy documents time consuming, but it can also be inaccurate. It’s not hard to imagine reading through an 80 page document and missing the detail you’re looking for.”⁵

Under the proposal, shareholders always have the option of requesting a paper copy. Given that a stated purpose of the proposal is to reduce printing and mailing costs, it does not seem appropriate to exclude a class of transactions because the proxy materials may be lengthy.

The fact that business combinations constitute “highly extraordinary events” for some companies likewise does not provide a compelling reason for excluding them. Other “extraordinary events,” such as proxy contests, are covered under the proposal.

In addition, some types of business combinations that the Commission proposes to exclude would not constitute “extraordinary events.” For example, a mutual fund manager

⁵ Opening Statement at SEC Open Meeting by Chairman Christopher Cox, U.S. Securities and Exchange Commission (Nov. 29, 2005), at 3.

may seek to merge two funds advised by the manager that have similar investment objectives, policies and strategies.⁶ Such a merger may promote more efficient portfolio management and eliminate the duplication of resources and costs associated with marketing and servicing the funds as separate entities. Fund shareholders may benefit, for example, from resulting economies of scale.

Fund mergers occur frequently. In 2002, the Commission staff estimated that, going forward, there would be approximately 400 mergers of affiliated funds or portfolios annually.⁷ Given how common these transactions are, excluding them will significantly limit opportunities for funds to utilize the “notice and access” model, thereby limiting the benefits of the proposal for fund shareholders.

For all of these reasons, the Institute urges the Commission to extend the “notice and access” model to business combinations. At a minimum, the Commission should make the “notice and access” model available for mergers of affiliated funds conducted in reliance on Rule 17a-8 under the Investment Company Act of 1940. These relatively routine transactions involve funds within the same complexes, and that have the same investment adviser. As such, these mergers should not be viewed as “extraordinary events.”

Investment Company Shareholder Reports

The proposal permits operating companies to rely on the “notice and access” model to provide annual reports to security holders. The Institute strongly urges the Commission to make this option available for investment company shareholder reports. The Proposing Release notes that the requirement to furnish annual reports in Rules 14a-3 and 14c-3 under the Exchange Act does not apply to registered investment companies. We do not believe this is a sufficient reason to exclude investment company shareholder reports from the proposal.⁸ If the Commission has concluded that the proposed delivery method is appropriate for proxy materials and for annual reports of operating companies, it should be equally appropriate for investment company shareholder reports. All of the documents contain important information for shareholders.

Greater Internet availability of fund shareholder reports may encourage more fund shareholders to review them in this convenient, easily navigable format. In addition to providing search capabilities, online disclosure facilitates comparisons. The Commission adopted new, standardized expense disclosure requirements for fund shareholder reports in

⁶ See 1 Thomas P. Lemke et al., *Regulation of Investment Companies*, §5.07 at 5-41 (Matthew Bender ed. 2005) (“The most common mergers involve public funds with similar investment objectives . . .”).

⁷ See SEC Release No. IC-25666 (July 18, 2002) (Investment Company Mergers), at n.53 and accompanying text.

⁸ Moreover, stock exchange rules require listed closed-end investment companies – just like other listed companies – to send annual reports to shareholders before or with proxy materials. See, e.g., New York Stock Exchange Listed Company Manual Rule 401.04 (stating that the “standard Listing Agreement requires that the annual report be sent to shareholders not later than 120 days . . . after the close of the company’s fiscal year and at least 15 days in advance of the annual meeting”).

2004 that are intended to help investors compare ongoing costs among funds.⁹ Making the reports available on the Internet under the “notice and access” model will promote this Commission objective.¹⁰ At the same time, those shareholders who wish to receive a paper copy will be able to do so.

Shareholders pay the costs of printing and mailing shareholder reports. These costs are substantial, given the number of these reports, which investment companies must send to shareholders twice each year. Two years ago, the Commission estimated that funds print and deliver approximately 462.4 million shareholder reports annually.¹¹ Use of the “notice and access” model could result in significant cost savings, consistent with the Commission’s stated intent in issuing the proposal.

Two-Day Turnaround Requirement

Under the Commission’s proposal, issuers that use the “notice and access” model are required to deliver a paper or e-mail copy of the proxy materials to any requesting shareholder within two business days after receiving the request. Funds and other issuers that choose to follow the “notice and access” delivery method will not know in advance how many requests for paper copies they will receive. To realize the cost savings that are intended by the proposal, many funds may print proxy materials only on an as-needed basis rather than printing large volumes of the materials in advance. The Institute is concerned that the two-day requirement will not accommodate this approach.

To address this concern, the Commission should revise the proposal to require funds and other issuers to respond to requests for paper copies within three business days. Our members have indicated that this change will allow for the printing and packaging of proxy materials on demand, which we understand can take more than two days. The time period we propose is consistent with the requirement in Form N-1A that when a fund receives a request for the Statement of Additional Information or a shareholder report, it must send the requested document within three business days.

We further recommend that the three business day turnaround requirement apply beginning 30 days before the shareholder meeting. If an issuer sends the Notice to shareholders earlier (*e.g.*, 45 days before the meeting), it should be permitted to aggregate requests for paper copies and respond to them as a group by no later than 30 days before the meeting. This approach will ensure that shareholders receive the materials sufficiently in advance of the meeting to have an opportunity to review them while also allowing for a more efficient printing and mailing process.

⁹ See SEC Release Nos. 33-8393; 34-49333; IC-26372 (Feb. 27, 2004), 69 Fed. Reg. 11243 (Mar. 9, 2004), at 11247.

¹⁰ Similar to the proposed approach for proxy materials, funds could send a brief, tailored notice to shareholders to inform them of the availability of shareholder reports.

¹¹ *Id.* at 11257.

Notice Content Requirements

The proposal limits the contents of the Notice to specific information. The Notice must be sent separately from other types of shareholder communications and may not be accompanied by any materials other than the proxy card and return envelope.

The Institute agrees that it is important for the Notice to be “furnished in a way that brings it to each shareholder’s attention.” At the same time, we believe that providing more flexibility with respect to the Notice’s contents and the information that may accompany the Notice will help attract shareholders’ attention and may promote greater participation in proxy voting. We recommend permitting issuers to include in or with the Notice impartial explanatory information designed to help shareholders understand the significance of the proxy solicitation and to anticipate general questions shareholders may have about the proxy proposals and voting mechanics.

Examples of the types of information that issuers might provide could include:

- An explanation of why shareholders have received the proxy;
- Information about why it is important to vote;
- Information about the proposal(s) to be voted upon (*e.g.*, in the case of an election of directors, a description of the role of the board of directors);
- A description of the methods that shareholders can use to vote; and
- If the proxy card is included with the Notice, instructions on how to sign the proxy card for different types of account registrations.

We believe that allowing issuers to provide additional, objective information along these lines will serve the interests of shareholders. Presenting these types of information in plain English and in a user-friendly format (*e.g.*, bullets or a question and answer format) in or with the Notice may attract the interest of shareholders more effectively than the Notice on its own. Under the proposal, the Notice must be filed with the Commission no later than the date it is first sent or given to shareholders. We recommend that the same filing requirement apply to additional impartial information sent with the Notice. The staff can perform spot checks to address any potential concerns about the content of these materials.

The Role of Intermediaries

Under the proposal, an intermediary (such as a broker or bank) may follow the “notice and access” model only if the issuer requests it to do so and, in such cases, must follow that model.¹² The Institute supports requiring intermediaries to follow the “notice and access” model upon the issuer’s request. It would be anomalous if a fund, for example, were to follow that approach, only to have intermediaries opt for paper delivery to their customers. Considering that more than 80 percent of fund shareholders who own funds outside of defined

¹² As noted in the Proposing Release, the proposal will not affect electronic delivery of proxy materials to those customers who have already affirmatively consented to it.

contribution retirement plans do so through intermediaries, this could greatly diminish the benefits of the proposal for funds and their shareholders.¹³

At the same time, we recommend that intermediaries be permitted to follow the “notice and access” model even if the issuer does not. In this way, intermediaries will retain the ability to take advantage of the proposed delivery method for the benefit of their customers.

Delivery of Proxy Materials to Retirement Plans

An issue may arise under the proposal for funds whose shares are held by defined contribution retirement plans. Plans that allow participants and beneficiaries to direct the investment of their accounts (*i.e.*, plans covered by section 404(c) of ERISA) are required by the Department of Labor (“DOL”) to provide those participants and beneficiaries with materials relating to the exercise of voting rights passed through to them under the terms of the plan.¹⁴ Current DOL regulations provide detailed requirements for electronic disclosure of materials required by ERISA, which might be viewed by DOL as inconsistent with the “notice and access” model.¹⁵ The Institute urges the Commission to work with DOL to ensure that retirement plan participants and beneficiaries are not deprived of the benefits of the proposal.

Electronic-Only Proxy Solicitations by Investment Company Shareholders

Shareholders of investment companies currently have two options to present an issue for general shareholder consideration. They can conduct their own proxy solicitations, provided that each person solicited is furnished with a proxy statement.¹⁶ Alternatively, they can prepare a shareholder proposal to be included on the investment company’s proxy card if they comply with certain minimum ownership and other requirements.¹⁷ The Commission’s proposal will allow shareholders to conduct an electronic-only solicitation on any matter of their choosing, without even sending a Notice to other shareholders.

The Institute agrees that investment companies and their shareholders should be able to conduct less expensive and more efficient proxy solicitations through the Internet. At the same time, we are concerned that the proposal as currently drafted could have unintended

¹³ See Investment Company Institute, “Ownership of Mutual Funds Through Professional Financial Advisers,” *Fundamentals*, Vol. 14, No. 3, April 2005, at 2.

¹⁴ See 29 C.F.R. §§ 2550.404c-1(b)(2)(i)(B)(1)(ix), -1(d)(2)(ii)(E)(4)(vii). Under DOL’s rules, plans are permitted, but not required, to pass through voting rights with respect to funds available as investment options. The rules require plans to pass through voting rights with respect to employer stock.

¹⁵ See 29 C.F.R. § 2520.104b-1.

¹⁶ See Rule 14a-3 under the Securities Exchange Act of 1934.

¹⁷ See Rule 14a-8 under the Securities Exchange Act (providing that any shareholder who continuously owns at least \$2,000 in market value or 1% of the company’s securities entitled to be voted on the proposal at the meeting for at least one year by the date the proposal is submitted, and who continues to hold those securities through the date of the meeting, is eligible to submit a shareholder proposal).

consequences, including the potential for diverting costs and resources involved in the proxy process, to the detriment of shareholders. Our recommendations for addressing this concern and other comments on electronic proxy solicitations by investment company shareholders are discussed below.

Bona Fide Solicitations

Under the Commission's proposal, any shareholder – regardless of the extent or length of time of his or her share ownership – may conduct an electronic proxy solicitation without having to print or mail any proxy statements. For example, a shareholder can issue a press release announcing a proxy solicitation, refer to the website where the proxy card and proxy statement are posted and never deliver any disclosure documents to shareholders. An electronic proxy solicitation may be launched at any time on any topic prior to a shareholder vote.¹⁸

Press reports suggest that the ease with which electronic solicitations can be conducted will cause dissident shareholders to launch more proxy fights.¹⁹ Institute members, particularly our closed-end fund members, have made similar observations. Because of the relative ease of the new process, we believe that shareholders may choose to conduct an electronic-only solicitation rather than submitting a proposal under Rule 14a-8.

Each time a shareholder solicits proxies, a fund must allocate time and resources to respond to, and otherwise manage the solicitation. Costs incurred by the fund include proxy solicitor fees and legal fees. Consequently, all shareholders ultimately bear some expense of the activities of soliciting shareholders whose objectives may not be shared by, or in the interests of, other shareholders.

To balance the ability of shareholders to engage in lower cost proxy solicitations against the potential burdens and costs for issuers and other shareholders, the Institute recommends that the Commission establish eligibility standards for shareholders to conduct electronic-only solicitations. We recommend that only those shareholders who own a specified minimum dollar amount or percentage of an issuer's voting securities for an established period of time be permitted to conduct electronic-only solicitations.

¹⁸ Under the proposal, there is no minimum time period during which a soliciting shareholder must make proxy materials available to shareholders if the materials are accessible only through a website. See Proposing Release at 74609. There are no limits on the matters that can be presented to shareholders.

¹⁹ See, e.g., Phyllis Plitch, *Moving the Market – Tracking the Numbers/Street Sleuth: SEC's Online Plan to Cut Costs May Rally Dissident Investors*, Wall Street Journal, Dec. 27, 2005, at C3 (quoting Bruce Goldfarb, senior managing director at Georgeson Shareholder Communications Inc., who stated with respect to the proposal generally: "I believe there will be more proxy fights initiated by dissidents who were previously deterred from acting because the printing and mailing costs were viewed as too high.").

Our recommendation is consistent with the Commission's longstanding approach for shareholder proposals. The Commission requires any shareholder who submits a proposal for inclusion on a company's proxy statement to have some prescribed economic stake or investment interest in the company to curtail potential abuse of this process.²⁰ For example, shareholders who conduct electronic-only solicitations could be required to own at least \$10,000 in market value or 1% of the company's securities entitled to vote on a proposal for at least one year as of the date the solicitation is commenced. These standards are based on Rule 14a-8 but adjusted to reflect the amount of a typical fund investment.²¹

We also recommend that shareholders who conduct electronic-only solicitations be required to send a Notice to the holders of a majority of the investment company's securities entitled to be voted at the meeting. This is a reasonable requirement to ensure a *bona fide* solicitation. It is also a means to assure that shareholders are provided information about a matter that is the subject of a solicitation at the soliciting shareholder's expense.

In addition, we recommend that the Commission staff monitor electronic solicitation materials submitted by investment company shareholders at least on a pilot basis. This will enable the Commission to monitor how this process is being used and to protect against possible abuses.²² We are concerned that in the absence of Commission scrutiny (or at least the prospect of such scrutiny), electronic solicitations potentially could be used to broadly disseminate inaccurate information to shareholders.

NYSE Interpretation for Contested Matters

Under New York Stock Exchange Rule 452, brokers are not permitted to vote uninstructed shares on contested matters. An NYSE interpretation of this provision suggests that a person other than the issuer must "solicit" at least 50% of the issuer's shareholders for a contest to exist under Rule 452.²³ The Commission requests comment on whether the widespread accessibility of a soliciting person's proxy statement and card on the Internet should affect the NYSE's interpretation.

²⁰ See SEC Release No. 34-20091 (August 16, 1983) (adopting Rule 14a-8's minimum ownership requirements).

²¹ See SEC Release Nos. 33-7512; 34-39748; IC-23064 (March 13, 1998), 63 Fed. Reg. 13915 (March 23, 1998), (where the Commission increased from \$1,000 to \$10,000 the assumed investment in a fund for purposes of the Example in a mutual fund prospectus's fee table showing a shareholder's expected expenses, recognizing the trend toward an increased size of fund investments).

²² Under Rule 14a-8, a company may seek to exclude a shareholder proposal from the company's proxy materials by filing a letter with the Commission stating the bases for exclusion. The Commission staff will then determine whether a proposal may be excluded prior to dissemination of the company's proxy card. The staff's advance review is designed to screen out improper or inappropriate proposals and to exclude false or misleading statements prior to publication. Unlike Rule 14a-8 proposals, the Commission staff will not necessarily review electronic-only proxy solicitation materials prior to their dissemination.

²³ Rule 14a-1(l)(iii) broadly defines "solicit" as the "furnishing of a form of proxy or other communication to shareholders under circumstances reasonably calculated to result in a procurement, withholding, or revocation of a proxy."

The Institute strongly recommends that the Commission urge the NYSE to amend its interpretation to make clear that the posting of a Notice, proxy card, or proxy statement on a web site will not be deemed a "solicitation" of a company's shareholders for purposes of the interpretation. Without this amendment, a shareholder posting a Notice on the Internet might make a matter on the company's proxy card "contested," and brokers will not be permitted to vote shares on that matter without instruction from beneficial owners. Investment companies will be required to contact their beneficial owners with the assistance and associated cost of proxy solicitors. Even with the assistance of proxy solicitors, it will be difficult for an investment company to reach its beneficial shareholders because many of them have indicated that they object to their brokers (or banks) disclosing their contact information to the investment company.²⁴

As a result, investment companies potentially will have significant difficulty getting a contested matter approved (*e.g.*, election of directors), leading to multiple solicitations and possible adjournments with the attendant costs when a shareholder conducts an electronic-only solicitation contesting a matter on the company's proxy card. Consequently, it would be relatively easy to disrupt the proxy process. This outcome does not serve the interests of investment company shareholders.

For purposes of the interpretation, we urge the Commission to recommend that the NYSE consider shareholders to be solicited only if the soliciting shareholder delivers a Notice to them by U.S. mail or e-mail. We do not believe it is reasonable to conclude that shareholders who have not been so notified have been solicited. Under our recommended approach, a soliciting shareholder would have to deliver a Notice by U.S. mail or e-mail to at least 50% of an issuer's shareholders contesting a matter on the company's proxy card for a contest to exist under Rule 452.

Timing Requirements for Notice

Under the proposal, a third party that is not conducting an electronic-only solicitation must send out its Notice prior to the later of: (1) 30 days prior to the meeting; or (2) ten days after the issuer first sends out its proxy solicitation. In contrast, a third party that is conducting an electronic-only solicitation does not have to begin its solicitation or furnish proxy materials within any particular timeframe. We recommend applying the same timeframe requirements in both circumstances. These timeframes will permit companies to prepare responses to solicitations, thus ensuring that shareholders have information in time to make an informed decision with respect to a particular matter.

Unsolicited Shareholder Voting

²⁴ See Rules 14b-1, 14b-2, and 14a-13, which prescribe procedures for issuers, brokers, and banks to follow regarding communicating with shareholders. We recommend that the Commission examine these rules, including evaluating the appropriateness of making it easier for issuers to contact their beneficial shareholders whose shares are held in the name of a broker or bank.

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The Commission requests comment on how a shareholder that is not solicited directly but who goes to the soliciting person's Web site will vote his or her shares. The Commission asks whether a soliciting person should be required, upon request from such shareholder, to provide the shareholder with a means for voting, for example, by providing the shareholder with a personal identification number or similar unique identifier and form to submit a proxy or voting instructions. The Release also asks if rules should be adopted to address such voting systems to promote more accurate voting results.

We share the Commission's concerns about accurate voting results and support the adoption of rules to address these voting systems. At a minimum, the rules should require a means for identifying shareholders, so as to avoid counting more than one proxy submitted by a single shareholder on the same matter and to ensure that persons voting are entitled to vote (*e.g.*, that such persons are who they say they are and held shares on the record date).

* * *

The Institute appreciates the opportunity to comment on this important proposal. We commend the Commission for continuing to move towards greater use of the Internet to serve investors' information needs. If you have any questions about our comments or would like any additional information, please contact me at 202/326-5815, Frances Stadler at 202/326-5822 or Dorothy Donohue at 202/218-3563.

Sincerely,

Elizabeth R. Krentzman
General Counsel

cc: The Honorable Christopher Cox
The Honorable Cynthia A. Glassman
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Annette L. Nazareth

Robert L.D. Colby, Acting Director
Division of Market Regulation

Susan Ferris Wyderko, Acting Director
Division of Investment Management

About the Investment Company Institute

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The Investment Company Institute's membership includes 8,554 open-end investment companies (mutual funds), 654 closed-end investment companies, 162 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$8.802 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.