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October 31, 2018

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington D.C. 20549

Re: *SEC Request for Comments on the Processing Fees Charged by Intermediaries for Distributing Materials Other Than Proxy Materials to Fund Investors (File No. S7-13-18)*

Dear Mr. Fields:

The Investment Company Institute[1] commends the Commission for its recent request for comment on the framework regulating fees that intermediaries charge funds for distributing certain disclosure materials to fund investors, such as shareholder reports and prospectuses ("fund materials").[2] It is critical to resolve the longstanding problems with the current framework that has cost fund shareholders millions of dollars. We have worked closely with our members to identify the problems with the current framework and propose several potential solutions. We stand ready to provide additional information and assistance as necessary to improve the current system.

## I. Background and Executive Summary

***Prevalence of intermediary accounts.*** Intermediary omnibus positions (*i.e.*, shareholder positions held with intermediaries such as broker-dealers) make up a significant portion of mutual fund assets. This means that fund records only identify the intermediary as the record owner, and the fund has limited information about the underlying beneficial shareholders. This

[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$22.7 trillion in the United States, serving more than 100 million US shareholders, and US$7.3 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 Request for Comments on the Processing Fees Charged by Intermediaries for Distributing Materials Other Than Proxy Materials to Fund Investors*, SEC Release Nos. 33-10505; 34-83379; IC-33114 (June 5, 2018), *available at* https://www.sec.gov/rules/other/2018/33-10505.pdf ("Release"). For the sake of simplicity, we use "investment company" and "fund" interchangeably to refer to registered investment companies and their affiliated transfer agents and advisers throughout this letter.

system allows intermediaries to take advantage of technology and recordkeeping capabilities. It also permits intermediaries to more closely align their mutual fund and brokerage systems and more efficiently manage their customer's entire financial portfolio across a spectrum of investments. At the same time, it means that funds have limited information about the identity of these beneficial shareholders and thus no ability to communicate with them directly. Funds therefore must rely on intermediaries to deliver fund materials to these shareholders.[3]

***Current system lacks appropriate incentives***. SEC rules require funds to reimburse intermediaries for reasonable expenses incurred in forwarding fund materials to beneficial owners of fund shares. Intermediaries generally outsource forwarding of fund materials to a fulfillment vendor that then invoices the fund to pay the expenses. This reimbursement system creates a disconnect between the party that negotiates the vendor fees (*i.e*., the intermediary) and the party that pays the vendors' bill (*i.e*., the fund).

Because funds bear the cost of shareholder report delivery, intermediaries have little incentive to negotiate lower delivery rates with the fulfillment vendor or otherwise control costs. To make matters worse, the lack of properly aligned incentives prevents competition and has created a near-monopoly for the predominant vendor, which now has a financial stake in keeping the status quo.

***The result is higher costs to fund shareholders***. This environment inevitably has led to significantly higher fees than funds pay when they select their own delivery vendor and negotiate the fee. Individuals can and do purchase fund shares directly from the fund. These shareholder accounts are held directly with the fund ("direct-held accounts"). Vendors compete to offer funds attractive pricing for delivering fund materials to direct-held accounts.

A recent ICI member survey found that the median fund pays ***three times*** as much in processing fees for mailing the same shareholder report to an intermediary-held account as compared to a direct-held account. The median fund pays ***five times*** as much to e-mail the same shareholder report to an intermediary-held account as compared to a direct-held account.

***NYSE fee schedule is not suited for funds and cements higher fees.*** The NYSE fee schedule sets maximum rates for what constitutes "reasonable" delivery expenses (*i.e*., "processing fees") that funds must reimburse, in addition to actual out-of-pocket costs such as printing and mailing.

The NYSE fee framework is ill-suited to distribution of fund materials, however, and the fees that apply to funds bear little relation to the actual work and cost of distributing fund materials.[4] As a result, fees charged pursuant to the schedule are higher than necessary to compensate for reasonable delivery expenses.

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[3] As a technical matter, fund shareholders who invest in the fund through intermediaries are underlying beneficial account owners ("intermediary-held" or "beneficial" accounts). Throughout this letter, we may refer to these fund shareholders as "beneficial owners."

[4] Although this letter focuses on distribution of fund materials other than proxies, many of our concerns also apply in the proxy context, and we believe the NYSE fee schedule also is ill-suited for distribution of fund proxy materials.

***Processing fees will reduce Rule 30e-3 cost savings.*** The Commission recently adopted Rule 30e-3 under the Investment Company Act of 1940 to, among other things, provide cost savings to shareholders (*i.e.,* by allowing funds to mail a notice instead of the full shareholder report, which will reduce printing and mailing costs). An additional processing fee will apply to these Rule 30e-3 Notices, however, and this will greatly reduce potential cost savings. Without further SEC action, this added processing fee may largely offset the cost savings from the reduced printing and mailing costs.

***SEC can facilitate greater competition***. The SEC should permit funds to select the fulfillment vendor and negotiate the price for distribution of fund materials. This will realign incentives and reintroduce market competition, eliminating the need for a regulator-set fee schedule and allowing vendors to compete for funds' business.

***Two potential solutions exist for the SEC to encourage greater competition***. We suggest two possible regulatory solutions that would permit funds to negotiate with vendors and eliminate the need for a fee schedule:

1. The SEC can make clear that Section 14 rules under the Securities Exchange Act of 1934 permit funds to choose how to deliver fund regulatory materials and require intermediaries to provide on request to funds or their selected agent (*i.e*., vendor) a data file with only the shareholder information necessary for delivering these materials;
2. Or, the SEC can allow funds to choose how to deliver fund regulatory materials by not applying the objecting beneficial owner (OBO)/non-objecting beneficial owner (NOBO) distinction for the purpose of distributing fund regulatory materials.

***Alternative recommendation for reforming NYSE fees***. If the SEC pursues neither of these two solutions, it must rework the fee schedule to:

- Create a fee schedule for funds that is separate from the existing NYSE fee schedule, recognizing that the fees for forwarding of fund materials to intermediary-held accounts are unrelated to the fees for forwarding of operating company proxy materials;
- Replace the existing fees and layered application structure with simple flat fees that reflect actual costs, using cost for direct-held accounts as a guide;
- Clarify that funds cannot be charged for managed accounts where funds are not required to forward materials;
- Eliminate unreasonable billing practices, such as remittances, that maximize intermediary and vendor profit at shareholder expense;
- Create a robust regulatory oversight framework; and
- Mandate regular independent review of fee rates and vendor billing practices.

## II. Current Fee Framework Prevents Market Competition and Increases Costs for Fund Shareholders

The Section 14 rules under the Exchange Act create a fundamental disconnect in incentives that prevents competition and results in significantly higher fees for funds and their shareholders.

### A. Intermediary reimbursement framework impedes competition: Intermediary negotiates price and fund pays the bill

The Release asks whether the SEC's rules under Section 14 of the Exchange Act are well-tailored for the distribution of fund materials.[5] Most emphatically, they are not. The process of reimbursing intermediaries for forwarding fund materials is built on a fundamental disconnect that creates perverse incentives and inhibits market competition. The intermediary negotiates the price and the fund pays the bill. Importantly, the cost of forwarding fund materials to beneficial shareholders is a fund shareholder expense, ***not*** an expense of the investment adviser to the fund.[6]

Under SEC rules, intermediaries must deliver fund materials to beneficial owners of fund shares.[7] An intermediary does not need to forward these materials, however, unless the fund provides assurance of reimbursement of the intermediary's ***reasonable*** expenses, both direct and indirect, incurred in connection with delivering the materials.[8]

Intermediaries generally outsource forwarding of fund materials to a fulfillment vendor that then invoices the fund for reimbursement of expenses. Since funds bear the cost of shareholder report delivery, intermediaries have little incentive to negotiate lower delivery rates with the fulfillment vendor or otherwise control costs for funds. Without market forces, the NYSE fee schedule instead sets a cap on the maximum "reasonable" reimbursement that intermediaries can charge funds for "processing" of forwarding materials.[9] Funds almost always are charged this maximum rate, as intermediaries lack the incentive to negotiate a lower rate for funds. By contrast, no such

[5] *See* Release, *supra*, at p. 12.

[6] The Release asks whether processing fees and other expenses connected with distributing fund materials to investors are considered and treated as direct fund expenses. *See* Release, *supra*, at p. 13. These are expenses borne by funds and their shareholders.

[7] Exchange Act Rules 14b-1 and 14b-2 require broker-dealers and banks (*i.e.*, intermediaries) to deliver fund shareholder reports to intermediary-held accounts.

[8] Exchange Act Rule 14b-1(c)(2)(i). *See also* Section 6(b)(4) of the Exchange Act, which provides that "[a]n exchange shall not be registered as a national securities exchange unless the Commission determines that . . . rules of the exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities." *See also* NYSE Rule 451.90 ("The Exchange has approved the following as fair and reasonable rates of reimbursement of member organizations for all out-of-pocket expenses, including reasonable clerical expenses, incurred in connection with proxy solicitations and the processing of proxy and other material pursuant to this Rule 451.").

[9] Funds additionally must provide reimbursement for out-of-pocket costs, such as the printing and postage cost for a mailed shareholder report.

conflict exists when funds select their own vendor to deliver materials to shareholder accounts held directly with the fund.

The Release asks what factors may affect the level of competition in the market for fulfillment vendors and their fees.[10] We explain below how the existing reimbursement framework interferes with competition and has created a near-monopoly for the predominant vendor. Almost all intermediaries select the same fulfillment vendor.[11] Intermediaries have systems in place to send fund shareholder records to the vendor. The vendor handles fulfillment, interprets and applies the fee schedule, and invoices the fund for its services.

Even when the intermediary negotiates a rate with the vendor that is lower than the NYSE-set maximum rate, the fund generally does not receive the lower rate. When the intermediary negotiates a lower rate, it is common practice for the vendor to bill the fund for the maximum rate, and then "remit" a portion of the fund's payment back to the intermediary, referred to as a "remittance."[12]

The Release asks whether the presence or absence of competition affects the level of fees assessed or the size of remittances.[13] The absence of competition leads to higher prices, and remittances limit the opportunity for market competition to develop on its own.[14] Vendors cannot compete on cost because intermediaries have no reason to consider cost. Offering a larger remittance presents the only incentive for an intermediary to switch to a different vendor.

### B. The result is significantly higher fees for fund shareholders

The Release asks how fees charged to funds for delivering fund materials to beneficial accounts compare with fees for comparable services that funds are able to negotiate on behalf of their direct-held accounts or NOBOs known to the fund.[15]

We recently gathered data from ICI members to compare the amount that funds pay in processing fees for shareholder report delivery per intermediary-held account against the amount per direct-held account.[16] The difference is startling and raises real concern about whether the fee

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[10] *See* Release, *supra*, at p. 17.

[11] Broadridge Financial Solutions, Inc. handles delivery of fund materials for almost all intermediary-held accounts.

[12] Neither the vendor nor intermediaries provide transparency into what portion of the fees collected from funds are remitted to each intermediary.

[13] *Id.*

[14] This is not a recent issue. *See Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change Relating to a One-Year Pilot Program for Transmission of Proxy and Other Shareholder Communication Material*, SEC Rel. No. 34-38406 (Mar. 14, 1997) [62 FR 13922 (Mar. 24, 1997)], at 13927 ("SEC 1997 Order") ("Moreover, several of these commenters believe that revenue sharing and rebates [*i.e.*, remittances] artificially inflate expenses charged to issuers and create an unnecessary barrier to entry for competition . . . .").

[15] *See* Release, *supra*, at p. 16.

[16] We received data from 1,704 mutual funds from 50 ICI members. Collectively, these members have 2,901 mutual funds that total $7.3 trillion in assets under management as of August 2018.

schedule represents reasonable expenses for delivery of fund materials.

For intermediary-held accounts, funds pay 15 cents for each mailed shareholder report (the "processing unit" fee) and 25 cents for each "suppressed" report (the "preference management" fee), where the need to mail materials in paper format has been eliminated.[17] "Suppression" of mailings occurs, for example, when the account holder has opted for electronic delivery, or in cases where multiple account holders share the same address and delivery of multiple copies is not required ("householding"). Funds also are charged this preference management fee for managed account records, even where funds are not legally required to forward materials.[18]

For direct-held accounts, our survey found that half of reporting funds pay 5 cents or less per report.[19] This includes both mailed and "suppressed" shareholder reports. For mailed shareholder reports, the NYSE processing fee charge of 15 cents is ***three times*** as much as the median cost from our survey to mail that same shareholder report to a direct-held account. For "suppressed" shareholder reports, the NYSE processing fee charge of 25 cents is ***five times*** as much.

Twenty-five percent of reporting funds indicated that they paid no processing fees at all for shareholder report delivery to direct-held accounts.[20]

[17] The NYSE fee schedule sets these fees, which we explain in further detail in Section III.A. We also discuss our longstanding concerns over how these fees are set, applied, and overseen.

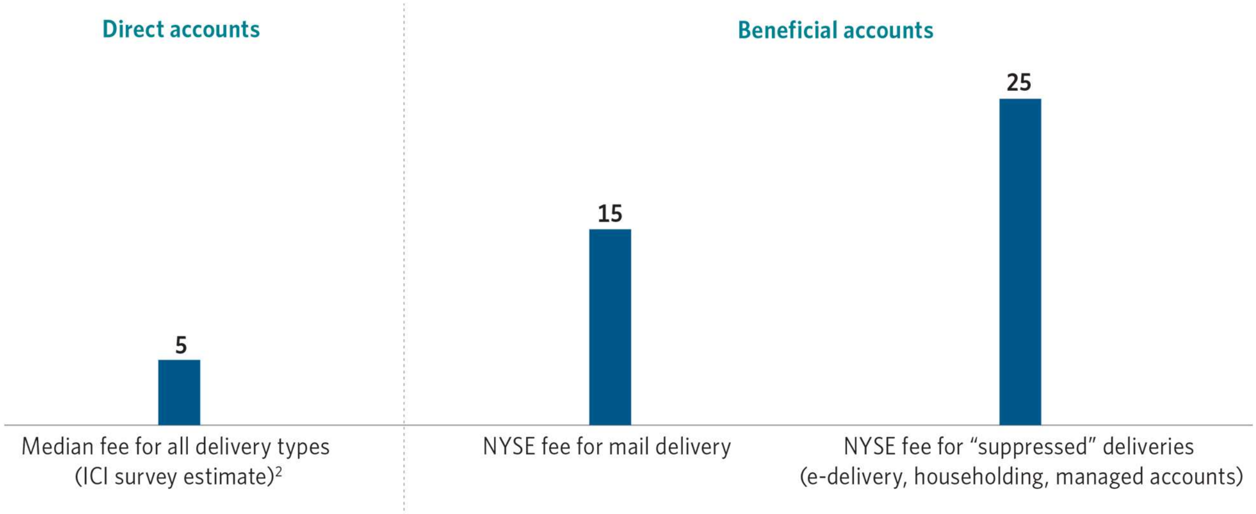
[18] *See infra* Section VI.C.

[19] Median is based on funds that mailed or "suppressed" at least 100 shareholder reports for their direct accounts.

[20] For example, some fund complexes handle delivery of fund materials or the creation of mail files in-house and do not charge processing fees to the funds.

**ICI Member Survey Indicates Processing Fees that Funds Pay for Direct Accounts Are Significantly Less Than NYSE Processing Fees**

*Processing Fees for Delivery of Fund Shareholder Reports to Direct[1] and Beneficial Accounts, Cents*




[1] Data on processing fees for direct accounts obtained from survey of 1,704 mutual funds from 50 ICI members.
[2] Median based on funds that mailed or suppressed at least 100 shareholder reports for their direct accounts.
Source: ICI tabulations of data from ICI members, and the schedule of NYSE processing fees

This striking disparity in fees shows that vendors are willing and able to deliver fund shareholder reports for a fraction of the fee rates currently set forth in the NYSE fee schedule.[21]

This substantial differential also demonstrates that the current fee schedule does not reflect the actual cost of delivering fund shareholder reports to intermediary-held accounts. Indeed, this analysis and other anecdotal information that many of our members have provided show that the current fee schedule plainly does not meet the statutory standard of reasonableness under the Exchange Act.[22]

## III. NYSE Fee Schedule Is Ill-Suited for Funds and Cements Higher Fees

The Release asks whether the NYSE fee schedule should apply to forwarding of fund materials.[23] The NYSE fee framework is ill-suited to distribution of fund materials and has failed to address intermediaries' lack of incentive to control costs for funds. The NYSE fee schedule sets rates for what constitutes "reasonable" distribution expenses (*i.e.*, "processing fees"), in addition to actual out-of-pocket costs such as postage.

[21] We understand that some fund complexes hire Broadridge as the vendor to deliver shareholder reports to their direct-held funds. We urge the SEC to explore whether Broadridge charges funds lower fees for delivery to direct-held accounts, where funds are able to negotiate the fees.

[22] *See* Section 6(b)(4) of the Exchange Act.

[23] *See* Release, *supra*, at p. 12.

We explain below:

- A brief history of the NYSE fee schedule and how the fees are intended for the distribution of operating company proxy materials;
- how applying these operating company proxy fees in the context of distributing fund materials results in additional expense for fund shareholders that does not reflect actual cost; and
- the types of fees that apply to funds and how they are ill-suited to distribution of fund materials.

### A. NYSE fee framework is tailored for operating company proxy distributions not fund materials

NYSE initially created the fee schedule for the distribution of operating company proxy materials.[24] Although these fees currently apply also to distribution of fund materials, this application is an accident of history that does not reflect the intended purpose of the fees. Appendix A contains a more complete description of how the NYSE fee schedule has developed.

For many years, the SEC has believed that self-regulatory organizations (SROs) are best positioned to fairly evaluate and allocate the costs associated with the distribution of shareholder materials.[25] Historically, NYSE has taken the lead in establishing the proxy fee structure for broker-dealers, banks, and issuers.

For its last review of the fee schedule, NYSE formed the Proxy Fee Advisory Committee (PFAC) (composed of operating company issuers, broker-dealers, one mutual fund company, and NYSE representatives) to review the existing structure for reimbursement fees that issuers pay for the distribution of proxy materials to investors who invest through intermediary-held accounts.[26]

[24] The NYSE rule setting forth the fee schedule is titled "Schedule of approved charges by member organizations in connection with proxy solicitations." *See* NYSE rule 451.90.

[25] *See* SEC Rel. No. 34-21900, 50 Fed. Reg. 13,297 (Apr. 3, 1985) ("In adopting the direct shareholder communications rules the Commission left the determination of reasonable costs to the SROs, because, as representatives of both issuers and brokers, they were deemed to be in the best position to make a fair allocation of the costs associated with the amendments, including start-up and overhead costs.").

[26] *See Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name, and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform*, SEC Rel. No. 34-70720 (Oct. 18, 2013), at p. 7, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-70720.pdf ("SEC October 2013 Order"). The PFAC was formed in September 2010 and began its review in conjunction with the SEC's concept release on the proxy system.

At that time, we expressed a number of concerns with the existing fee framework and recommended that the Commission:

- conduct an independent third-party audit of the current fee structure to establish reasonable rates of reimbursement;
- assess the reasonableness of the rates periodically thereafter; and
- work toward the establishment of a more competitive marketplace for the distribution of proxy materials.[27]

We also asked the SEC to focus on giving issuers the flexibility to choose providers to deliver their materials, since this would accelerate the development of a more competitive marketplace and, in turn, help rationalize fees and increase transparency."[28]

The PFAC released a report in May 2012, recommending changes to the fees charged for distributing fund materials.[29] The PFAC's recommendations were not based on an independent review of actual cost, but relied on public information about vendor profitability as well as the vendor's own analysis of whether the NYSE fees aligned with its work effort.[30]

In February 2013, the NYSE filed proposed rule changes with the SEC to codify most of the PFAC's recommendations.[31] NYSE, in submitting the revised fee schedule to the SEC for approval, stated it believed that the changes would result in lower fees.[32] This representation appeared to be an important factor for the SEC in its approval of the revised fee schedule. NYSE based its representation on data from the predominant vendor and a small sampling of brokers,

[27] *See* Letter from Karrie McMillan, General Counsel, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Oct. 20, 2010, at p. 7-10, available at https://www.sec.gov/comments/s7-14-10/s71410-167.pdf ("ICI 2010 Letter").

[28] *See id.* at p. 8.

[29] *See Notice of Filing of Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform*, SEC Rel. No. 34-68936 (Feb. 15, 2013), at p. 47, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-68936.pdf ("SEC February 2013 Notice") ("The PFAC's recommended changes should have a relatively modest impact on mutual funds, and the PFAC did not recommend changes to the interim report fees, which are the ones most applicable to mutual funds.").

[30] *See id*. at p. 11 ("The Committee also focused on whether the new recommended fees appear to be aligned with the work effort to which the fees relate. At the Committee's request, Broadridge analyzed the work effort across the several tasks involved in proxy distribution. The Committee observed that this analysis confirmed that fees and work effort appeared to be roughly in line."). *See also* SEC October 2013 Order, at p. 62, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-70720.pdf (noting that "the Commission questioned the rigor with which the PFAC and the Exchange reviewed the costs associated with proxy processing in developing its recommendations, and noted the PFAC's reliance on publicly available financial information about Broadridge that did not break out the proxy distribution business as a standalone segment, as well as related analyst reports").

[31] *See* SEC February 2013 Notice, *supra*.

[32] *Id.*

indicating that issuer-paid fees overall would decrease by approximately four percent and mutual fund-paid fees would be modestly affected.[33]

In comments on the NYSE's proposed rule changes, ICI reiterated its strong concerns and opposed several aspects of the proposal because it failed to create an incentive to reduce fees.[34] The SEC approved the NYSE rule change in October 2013 without addressing ICI's concerns.[35]

The PFAC recommended revisiting the fee schedule in three years (*i.e.,* 2016) to ensure that the fees were operating as the predominant vendor represented.[36] That recommendation was not followed but has proven to be well placed, as new information demonstrates that the fees in fact are not operating as intended, at least with respect to funds. Instead, the NYSE fee schedule, as currently implemented, results in funds paying fees far higher than necessary to reimburse for delivery of fund materials to intermediary-held accounts.

### B. Applying a fee schedule developed for operating company proxies results in higher fees for funds

The NYSE fee schedule applies to distribution of fund materials in a radically different manner than to distribution of operating company materials. Funds have a regulatory requirement to distribute "interim" materials multiple times per year. Operating companies rarely distribute interim materials and therefore rarely incur these fees. Processing fees for interim materials apply to all distributions of fund materials that are not proxy materials. As a result, processing fees that NYSE developed for occasional operating company interim mailings have a disproportionate impact on funds and their shareholders.

Operating companies are required to deliver a single shareholder report annually (*i.e.*, the company's annual report) in conjunction with the company's annual proxy solicitation.[37] The processing fees for interim materials do not apply to this annual operating company distribution. Rather, these fees cover delivery of any non-proxy mailing, such as marketing or investor relations material. There is no regulatory requirement for operating companies to send these interim mailings. The fees for interim materials therefore rarely apply in the operating company context.

In contrast, neither mutual funds nor exchange-traded funds are required to solicit annual proxies (and generally do not), but have a regulatory requirement to deliver two shareholder reports

[33] *See id.*, at p. 47 (noting that "[the] recommended changes should have a relatively modest impact on mutual funds").

[34] Letter from Dorothy M. Donohue, Deputy General Counsel—Securities Regulation, ICI, to Elizabeth M. Murphy, Secretary, SEC, dated Mar. 15, 2013, *available at* https://www.sec.gov/comments/sr-nyse-2013-07/nyse201307-14.pdf ("ICI March 2013 Letter").

[35] *See* SEC October 2013 Order, *supra*.

[36] *See id.*, at p. 48.

[37] *See* Rule 14a-3 under the Exchange Act.

annually.[38] Funds generally deliver an annual prospectus update as well, which is also subject to these interim material processing fees.[39] These fees also apply to funds' deliveries of Rule 19a-1 distribution notices and other regulatory materials sent to investors that are not proxy solicitations.[40] This means that funds have no choice but to pay NYSE-set fees for interim materials at least three times a year—far more frequently than the operating companies for which the fee schedule was created. In certain circumstances such as material changes to funds' offering documents or to comply with exemptive orders, funds must send additional materials to shareholders, generating additional fees.

### C. Fees that apply to funds are ill-suited to distribution of fund materials

Several types of processing fees[41] that apply to funds were established for operating companies, are ill-suited to distribution of fund materials, and result in higher costs for fund shareholders. Funds pay the following types of fees for distribution of interim materials:

- Processing unit fee: 15 cents charged for *all* beneficial account records, for each distribution of fund materials, regardless of whether that account receives a mailed distribution of materials.

- Preference management fee: 10 cents *in addition* to the processing unit fee charged for each distribution of fund materials, for each "suppressed" account record where the need to mail materials in paper format has been eliminated, as reimbursement for tracking the shareholder's delivery preference.

- Notice and access fee: tiered fee with breakpoints ranging from 5 to 25 cents per account, charged *in addition* to the processing unit fee for each account record that receives a Rule 30e-3 Notice or other notice and access mailing (*e.g.*, manager-of-manager change notice required by exemptive order).

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[38] *See* Rule 30e-1 under the Investment Company Act.

[39] These processing fees also apply to distributions of any prospectus supplements.

[40] Section 19(a) of the Investment Company Act generally prohibits a fund from making a distribution from any source other than the fund's net income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment. Rule 19a-1 specifies the information required to be disclosed in the written statement.

[41] We note that these fees are charged solely for "processing." Funds may be charged additional fees that are not regulated by the NYSE fee schedule. For example, we understand a fund may be charged an additional 5 cent fee for the cost of sending of an e-mail.

*1. Processing unit fee: funds deliver "interim" materials far more frequently than operating companies, leading to higher costs*

NYSE rules allow for the application of a base processing unit fee up to 15 cents for each account for annual reports processed separately from proxy materials, for "interim reports," and for "other material."[42]

*Disconnect between cost and effort*. It is unclear what intermediary efforts the 15 cent processing unit fee is intended to reimburse outside of the traditional proxy context.[43] It is our understanding that a vendor receives a fund shareholder position file from the intermediary and that this fee applies each time their system "reads" an account record in that shareholder position file. We also understand that the actual cost of this "running a record" is very small (1 to 2 cents) for distributions of fund materials to direct-held accounts.

*Base processing unit fee still charged for* ***not*** *delivering fund materials*. We understand it is vendor practice to charge this 15 cent fee for each beneficial account record in the fund, each time there is a distribution of fund materials, regardless of whether that account receives a mailed distribution of materials. This fee is charged for accounts that receive distributions via e-mail (*i.e.*, "electronic delivery" or "e-delivery"),[44] accounts that are householded and do not receive any distributions at all, and managed accounts where there is no distribution requirement at all. It is nonsensical that this processing unit fee is charged *not* to deliver a document.

*Multiple charges for single report*. The processing unit fee also is charged per account record when a fund delivers a consolidated shareholder report. In this case, the vendor charges this fee for each fund an investor holds, even if the investor only receives one report. For example, if an investor owned three funds and received one consolidated annual report, the vendor would charge three processing unit fees, even though the investor is only receiving one annual report.

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[42] *See* NYSE rule 451.90(3); Supplementary Material .01(a)(4) to FINRA rule 2251.

[43] In the 2013 fee schedule amendments, NYSE represented that the work effort associated with this fee is separate and in addition to the activities supporting the preference management fee. *See* SEC October 2013 Order, *supra*, at p. 43. But the NYSE letter that breaks out the percentage of total processing cost attributable to each of the various fees seems to contemplate processing only in the proxy context and assigns a high percentage of the work involved to "vote processing." *See* chart on p. 7 of memorandum appended to letter from Janet McGinness, EVP & Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, SEC, dated Sept. 9, 2013, *available at* https://www.sec.gov/comments/sr-nyse-2013-07/nyse201307-51.pdf.

[44] Investors may opt into receiving delivery of fund materials via e-mail rather than by mail. *See, e.g.*, *Use of Electronic Media for Delivery Purposes*, Investment Company Act Release No. 21399 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)] (providing Commission views on the use of electronic media to deliver information to investors, with a focus on electronic delivery of prospectuses, annual reports, and proxy solicitation materials); *Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information*, Investment Company Act Release No. 21945 (May 9, 1996) [61 FR 24644 (May 15, 1996)] (providing Commission views on electronic delivery of required information by broker-dealers, transfer agents, and investment advisers); *Use of Electronic Media*, Investment Company Act Release No. 24426 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] (providing updated interpretive guidance on the use of electronic media to deliver documents on matters such as telephonic and global consent, issuer liability for website content, and legal principles that should be considered in conducting online offerings).

Funds also are charged for each account record even when multiple documents (*e.g.*, annual report and summary prospectus) are bundled together in the same mailing.[45]

### 2. *Preference management fee: funds pay almost seventy percent more **not** to mail fund materials*

*Higher fees charged for **not** delivering fund materials.* Funds pay almost seventy percent more in processing fees *not* to mail fund materials than they pay to mail fund materials. NYSE permits funds to be charged a preference management fee of up to 10 cents per distribution of fund materials, for each "suppressed" account where the need to mail materials in paper format has been eliminated.[46] This preference management fee is charged each time that a shareholder report or annual prospectus update is available—three times per year for each "suppressed" account. This fee is charged *in addition to*, and not in lieu of, other fees permitted under the NYSE rules, including the 15 cent processing unit fee.[47]

Because the preference management fee is layered on top of the processing unit fee, funds pay 25 cents in processing fees for every e-delivered or householded shareholder report or prospectus—almost seventy percent more than the processing fees for a mailed document.

The preference management fee is intended to reimburse brokers (and therefore the vendor) for "significant processing work involved in keeping track of the shareholder's election," although the SEC's last review of these fees acknowledged that few shareholders actually change their election.[48] Despite that, NYSE and the SEC concluded in 2013 that "preference management" involves significant processing work based on representations from the predominant vendor and brokers about the work involved.[49]

ICI members' experience with the same "preference management" for funds' direct-held accounts stands in stark contrast. On the direct side, processing work is automated, does not involve significant processing work, and has negligible cost. For direct-held accounts, the overall

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[45] In Section III.C.4, we further discuss vendor practices around layering of fees.

[46] *See* NYSE rule 451.90(4); Supplementary Material .01(a)(5) to FINRA rule 2251.

[47] *See id.*

[48] *See Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name, and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform*, SEC Rel. No. 34-69622 (May 23, 2013), at p. 51, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-69622.pdf.

[49] *See* SEC October 2013 Order, supra, at p. 65. The Release asks about the proportion of preference management fees charged to funds as compared to the preference management costs that intermediaries bear in the course of sending their own materials to customers. *See* Release, *supra*, at p. 9. ICI members do not have transparency into how these costs are handled—and to what extent they are shared—by the intermediary. We do believe that intermediaries track customer delivery preferences for other intermediary mailings such as account statements.

processing costs for suppressed accounts are a mere fraction of the fees that apply in the NYSE fee schedule.[50]

*Different rationales created to justify same fee*. The justification for the preference management fee has changed over time, although the amount of the fee and its recurring nature have remained the same. Prior to the 2013 NYSE rule amendments, this fee was called an "incentive" fee.[51] At that point, the fee was intended to provide intermediaries with an incentive to household materials, therefore eliminating the need to mail proxy materials in paper format and reducing an issuer's forwarding costs.[52] Beginning in 2013, NYSE permitted vendors to repurpose the incentive fee as a fee for managing the shareholder's delivery preference (*i.e*., e-delivery or physical mail)—without any meaningful inquiry into whether this fee rate reflects actual cost of the related processing work.[53] At the same time, NYSE permitted vendors to charge processing fees for smaller balance retail managed accounts, substantially expanding the number of fund accounts subject to these fees.[54]

*Fee charged repeatedly for little or no additional work*. The Release asks whether the preference management fee should be eliminated once an investor selects e-delivery.[55] It should be. Rather than permitting a substantial, ongoing fee for what amounts to standard automated database processing, the preference management fee should be recharacterized as a one-time charge for the processing work involved in setting and tracking the shareholder's initial preferred method of delivery.[56]

*It is unwarranted to charge fund shareholders fees to promote e-delivery*. The Release asks how, if at all, the application of the preference management fee affects overall electronic delivery rates for distributions of fund materials.[57] We understand that e-delivery rates for intermediary-held accounts are higher than for direct-held accounts. Yet, this difference likely exists for reasons unrelated to application of the preference management fee.

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[50] *See* ICI's survey results in Section II.B.

[51] *See Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Its Rules Regarding the Transmission of Proxy and Other Shareholder Communication Material and the Proxy Reimbursement Guidelines Set Forth In Those Rules, and Requesting Permanent Approval of the Amended Proxy Reimbursement Guidelines*, SEC Rel. No. 34-45263 (Jan. 9, 2002), *available at* https://www.sec.gov/rules/sro//34-45263.htm ("SEC 2002 Notice").

[52] *See id*.

[53] *See* SEC October 2013 Order, *supra*, at p. 41.

[54] *See* SEC October 2013 Order, *supra*, at p. 21-22. *See also* discussion in Appendix B.

[55] *See* Release, *supra*, at p. 18.

[56] We question at least part of NYSE's apparent basis for deciding not to change the preference management fee to a one-time fee. NYSE's 2013 proposed amendments stated that "clearly, a change to a one-time fee would radically impact the overall revenue produced by the proxy fees, presumably requiring at least some compensating increases to the 'one-time' fee or to other proxy fees." *See* SEC February 2013 Notice, *supra*. We do not see why the need to avoid disrupting an existing revenue stream would justify maintaining a fee, if it is not a "reasonable expense" as provided for in Exchange Act Rule 14b-1(c)(2).

[57] *See* Release, *supra*, at p. 18.

Intermediaries deliver a profusion of materials other than fund materials—*e.g.*, account statements and marketing materials. This incents intermediaries to encourage their customers to opt into e-delivery. Intermediaries also interact more frequently than funds with the underlying shareholder, providing significantly increased opportunities for e-delivery adoption. It also is our understanding that intermediaries typically offer global consent to e-delivery. A fund can opt an investor into e-delivery only for that particular fund complex.

Funds paying preference management fees is not necessary to improve e-delivery adoption rates for intermediary-held accounts. Incentives to facilitate e-delivery already exist, and, in addition, increased market competition in the vendor fulfillment space naturally will incentivize vendors' technological improvements without requiring preference management fees from funds. Further, we are concerned that any regulator-mandated preference management fee that finances business improvements for existing vendors will practically act as a barrier to entry for new market participants.

The ability to e-mail fund materials reduces a fund's print and mail costs. Yet those savings do not justify applying an extra preference management (or "incentive") fee to e-delivered fund materials. Rather, this fee should be re-characterized as an e-delivery fee and should reflect actual cost to deliver fund materials via e-mail.

3. *Notice and access fee: tiered fee developed for operating company proxies is ill-suited for funds*

When a fund elects to send proxy materials via the "notice and access" method, NYSE rules permit the charging of a notice and access fee in addition to the processing unit fee.[58] The notice and access fee is a tiered fee based on the number of accounts per distribution with a schedule that begins at 25 cents per account and ultimately declines to 5 cents per account.[59] The Commission approved NYSE amendments applying the notice and access fee to distributions of fund shareholder reports under Investment Company Act Rule 30e-3.[60] An intermediary may not charge a notice and access fee for any account with respect to which a fund pays a preference management fee for the same distribution.[61] There are other circumstances as well where funds

[58] *See* NYSE rule 451.90(5); *see also* Supplementary Material .01(a)(6) to FINRA rule 2251.

[59] *See id*. Under the schedule, every fund will pay the highest rate (*i.e.*, 25 cents) for the first 10,000 accounts, or portion thereof, with decreasing rates applicable only on additional accounts in the additional tiers, with rates gradually falling to the fee of 5 cents for each account over 500,000 accounts. *See id.*

[60] *See Order Affirming Action by Delegated Authority Approving SR-NYSE-2016-55 and Discontinuing Stay*, SEC Rel. No. 34-83378 (June 5, 2018), *available at* https://www.sec.gov/rules/other/2018/34-83378.pdf ("SEC 2018 Order").

[61] *Id.* As an example of objectionable vendor practices that crop up in applying these fees, we highlighted to the SEC in past comments that the predominant vendor was planning to apply the tiered notice and access fee at the share class level, preventing funds from reaching fee breakpoints and significantly increasing the overall cost of these fees. *See* Letter from Paul Schott Stevens, President and CEO, Investment Company Institute, to Brent J. Fields, Secretary, US Securities and Exchange Commission, dated March 14, 2016, at A-7, A-8, *available at* https://www.sec.gov/comments/s7-08-15/s70815-581.pdf ("ICI 2016 Letter").

use the notice and access method of distributing materials to fund shareholders and are subject to these fees, such as for manager-of-manager change notices required by an exemptive order.

*Fee is ill-suited for delivering fund materials*. The notice and access fee should not apply to distribution of fund materials. The fee was developed for operating company proxy distributions—a much more complex undertaking than the distribution of fund materials.[62] Proxy distributions involve calculating the size of a shareholder's position; preparing objecting beneficial owner (OBO) and non-objecting beneficial owner (NOBO) lists; accepting, tracking and tabulating the shareholder's vote; transmitting periodic tabulation reports to the designated proxy solicitor; sending follow-up and reminder communications; and handling a small number of fulfillment requests for paper copies. Delivering a fund shareholder report is a simple matter of sending the report—via mail, e-mail, or Rule 30e-3 Notice.

### 4. *Layering of fees lacks transparency and significantly increases overall cost*

The layering of different processing fees significantly increases costs and makes it difficult for funds to track the different fees on vendor invoices. Here are examples that show how vendors can layer fees in unexpected ways under the NYSE schedule.

Example 1
An investor owns two share classes of the same fund.[63] The investor receives one summary prospectus in the mail. The vendor charges two processing unit fees (15 cents x 2) and one preference management fee (10 cents) for "suppressing" one mailing so that the investor does not receive two copies of the same prospectus.

Example 2
An investor owns three funds with the same fiscal year end. The investor receives one consolidated annual report in the mail. The vendor charges three processing unit fees (15

The vendor also had intended to layer the notice and access fee on top of both the processing unit fee *and* the preference management fee. In addition, the vendor had intended to apply the notice and access fee to *all* accounts, even accounts *not* receiving deliveries of Rule 30e-3 Notices. It defies logic to allow a vendor to apply a notice and access fee to accounts that are not receiving notices. Since the intermediary is the party negotiating with the vendor, however, the fund is unable to influence these types of discretionary determinations about how the fees apply. The SEC prevented this absurd result by directing NYSE to amend its rules, stating explicitly that the notice and access fee only applies to accounts that are receiving Rule 30e-3 Notices. *See* SEC 2018 Order, *supra*. Although NYSE addressed both of these issues at the SEC's direction, they stand as examples of how the fee schedule can be easily interpreted and applied in a manner that maximizes vendor profit at fund expense.

[62] The Release asks whether differences between proxy distributions and non-proxy distributions create significant differences in the costs of the applicable processing fees. *See* Release, *supra*, at p. 12.

[63] Holding multiple classes of the same fund can be common for certain classes—*e.g.*, where share lots of one class are automatically converted to another class after a certain period of time. Or an investor may hold one class in a taxable account and another class in a retirement account.

cents x 3) and two preference management fees (10 cents x 2) for "suppressing" two mailings so that the investor does not receive three copies of the same annual report.[64]

Example 3
An investor owns four funds with the same fiscal year end. The investor has opted for e-delivery and receives one e-mail with a link to the funds' consolidated semi-annual report. The vendor charges four processing unit fees (15 cents x 4) and four preference management fees (10 cents x 4) for "suppressing" the four mailings.

Example 4
An investor owns ten funds in a managed account, and the investor has delegated voting authority and receipt of shareholder mailings to the intermediary. The fund therefore has no regulatory requirement to deliver a shareholder report to the investor. When the funds release their annual shareholder reports, the vendor still charges ten processing unit fees (15 cents x 10) and ten preference management fees (10 cents x 10) for "suppressing" ten mailings.

## IV. Higher Fees Reduce Rule 30e-3 Cost Savings

Rule 30e-3 will provide print and mail cost savings for funds, since the Rule will permit funds to mail a short notice instead of a lengthy shareholder report.[65] But Rule 30e-3 Notices are subject to an additional NYSE processing fee—the notice and access fee—which will greatly reduce anticipated cost savings from Rule 30e-3.[66] The layering and the difficulty in estimating the tiered notice and access fee make it challenging to calculate the impact of this fee.[67] Without SEC action, the increase in applicable processing fees will reduce the cost savings from no longer printing and mailing shareholder reports.

In a March 2016 letter to the Commission, we estimated that processing fees for delivery of fund shareholder reports to intermediary-held accounts could erase an estimated $1 billion in potential cost savings for fund shareholders over the next 10 years.[68] NYSE made certain changes to the fee schedule.[69] Although we welcomed these changes, we remain concerned that application of

[64] We understand that some intermediaries aggregate account records before sending their data files to the vendor, so that the charges better align to the actual distributions of fund materials.

[65] ICI estimated that funds collectively spent $308 million to print and mail 440 million shareholder reports in 2014. We estimated funds would receive $162 million in ongoing annual print and mail savings, assuming the SEC adopted ICI's recommendations. *See* ICI 2016 Letter, *supra*, at A-7, A-8.

[66] The NYSE fee schedule applies a tiered notice and access fee when an issuer elects to utilize "notice and access" for a proxy distribution. NYSE Rule 451.90(5). This fee additionally applies to distribution of Rule 30e-3 Notices or other notice and access mailings (*e.g.*, manager-of-manager change notice required by exemptive order).

[67] The notice and access fee is not flat; it has tiers based on "job" size, so that the per account rate charged decreases as the size of the "job" increases. This tiering creates difficulty in determining the ultimate cost of the notice and access fee.

[68] *See* ICI 2016 Letter, *supra*.

[69] *Order Granting Approval of Proposed Rule Change Adopting Maximum Fees Member Organizations May Charge in Connection with the Distribution of Investment Company Shareholder Reports Pursuant to Any*

the notice and access fee will redirect a significant portion of Rule 30e-3's print and mail cost savings into paying increased processing fees.[70]

As a larger issue, ICI's estimates rely on information from the predominant vendor, and we remain concerned that actual costs could be significantly higher. Our original notice and access fee cost estimate increased significantly after we learned that the vendor planned to apply the notice and access fee breakpoints at the share class level rather than at the fund level.[71] This makes it more difficult for funds to reach lower cost breakpoints. As a result, the vendor estimate was more than double our estimate. At the SEC's direction, NYSE amended its fee schedule to clarify that the notice and access fee applies at the fund level rather than the share class level.[72]

Despite these changes, new vendor estimates now indicate that the average notice and access fee rate could reach 20 cents per Rule 30e-3 Notice distribution. Further, members recently informed us that the vendor will be charging a separate fee for maintaining a list of fund shareholders who choose to continue to receiving paper shareholder reports during Rule 30e-3's two-year transition period.

## V. Primary Recommendation: Realign Disconnect Between Who Negotiates and Who Pays, which Will Introduce Market Competition and Alleviate the Need for a Fee Schedule

The Release asks whether the Section 14 reimbursement framework is well-tailored for the distribution of fund materials and whether other Commission rules would be preferable.[73] That framework is not a good fit for the distribution of fund materials. The SEC must address this by realigning the disconnect between who selects the fulfillment vendor and who ultimately pays the bill for distribution of fund materials.

To resolve this disconnect, we recommend that the SEC permit funds to select the fulfillment vendor and negotiate the price for distribution of fund materials. This will realign incentives and eliminate the current problems with the fee structure.

The Release asks what steps, if any, the Commission should take to promote competition in the market for the distribution of fund materials to investors.[74] Resolving the disconnect between who selects the vendor and who pays will reintroduce competition, eliminating the need for a regulator-set fee schedule and forcing vendors to compete for funds' fulfillment business.

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*Electronic Delivery Rules Adopted by the Securities and Exchange Commission*, SR-NYSE-2016-55 (Nov. 18, 2016), *available at* https://www.sec.gov/rules/sro/nyse/2016/34-79355.pdf ("SEC 2016 Order").

[70] For example, one member estimates that the additional application of the tiered notice and access processing fee will offset approximately 90% of Rule 30e-3 savings from reduced print and mail costs.

[71] *See* ICI 2016 Letter, *supra*, at p. 7-8.

[72] *See* SEC 2018 Order, *supra*. *See also* SEC. Rel. No. 34-79370 (Nov. 21, 2016) [81 FR 85655 (Nov. 28, 2016)] (Stay Order) and SEC. Rel. No. 34-79355 (Nov. 18, 2016) [81 FR 85291 (Nov. 25, 2016)] (Approval Order).

[73] *See* Release, *supra*, at p. 12.

[74] *See id.*, at p. 17.

We suggest two possible solutions that would eliminate the need for a fee schedule:

1. The SEC can make clear that Section 14 rules permit funds to choose how to deliver fund regulatory materials and require intermediaries to provide on request to funds or their selected agent (*i.e.*, vendor) a data file with only the shareholder information necessary for delivering these materials—analogous to Rule 22c-2 under the Investment Company Act.

2. Or, the SEC can allow funds to choose how to deliver fund regulatory materials by not applying the "objecting beneficial owner" (OBO)/ "non-objecting beneficial owner" (NOBO) distinction for the purpose of distributing fund regulatory materials.

Each of these approaches has the potential to disrupt the existing plumbing that connects intermediaries with the predominant vendor. Nevertheless, some disruption of the status quo is necessary to create competition and realign incentives so delivery of fund materials is being negotiated with the shareholders' interest foremost in mind. These important factors outweigh the inconvenience of requiring intermediaries to transmit a simple data file with limited shareholder information.

### A. Solution #1: Interpret Section 14 rules to permit funds to choose how to deliver fund regulatory materials

Our preferred solution is for the SEC to interpret its rules under Section 14 so that funds may, but are not required to, select a fulfillment vendor and negotiate the fee rate. This approach aligns with how funds select the vendor to deliver materials to their direct accounts.

Instead of transmitting the shareholder information to the intermediary's chosen vendor, the intermediary would send a data file on request to the fund or its selected vendor.[75] The data file would contain only the shareholder information necessary for delivering regulatory fund materials, in a standardized format.[76] This new framework could operate similarly to Rule 22c-2 under the Investment Company Act.[77] In this case, the fund would be able to use the underlying shareholder information for the sole purpose of delivering regulatory materials, which should alleviate any intermediary concerns about maintaining control of shareholder information.

By analogy, Rule 22c-2 generally requires funds to enter into shareholder information agreements with intermediaries that submit orders to purchase or redeem fund shares on behalf

[75] Any rulemaking should address the risk of data breaches of any personally identifiable information (PII). Unless the breach is the result of the fund's handling of the data, data breaches should be the responsibility of the vendor or intermediary sending the data.

[76] We expect that ICI would work with funds and intermediaries to develop an industry standard template for this file.

[77] 17 CFR 270.22c-2(a)(2)(i). The SEC adopted Rule 22c-2 to help address abuses associated with short-term trading of fund shares.

of beneficial owners. These agreements provide the fund with limited information about transactions in intermediary-held accounts. The rule and agreements, however, do not require the information that would be necessary to enable the fund to deliver or transmit materials directly to beneficial owners.[78]

The SEC should apply a similar framework for transmitting shareholder information necessary to deliver fund regulatory materials. Intermediaries would need to transmit a data file with the following shareholder information: name, address, e-mail address, delivery preference, and the funds (CUSIPs) in which the investor holds shares.[79] As with Rule 22c-2, a fund and its agent would be permitted to use this data only for specified purposes—in this case, delivering regulatory materials.

B. Solution #2: Do not apply the OBO/NOBO distinction for the purpose of distributing fund regulatory materials

Alternatively, the SEC could allow funds to choose how to deliver fund regulatory materials by requiring intermediaries to maintain and provide lists of all fund shareholders and their delivery preferences solely for the purpose of distributing fund regulatory materials (Regulatory Mailing List), irrespective of their status as an OBO or NOBO.[80] This would allow funds to select their own vendor, negotiate a competitive price on behalf of fund shareholders, and then request the Regulatory Mailing List from the intermediary and provide it to the fund's selected vendor.[81]

Intermediaries already maintain the information that would be required in the Regulatory Mailing List. The generation of the Regulatory Mailing List should not be a difficult process considering the current existence of NOBO and OBO shareholder records. At most, the intermediary would be required to include certain additional shareholder information not in the NOBO list. Funds only need the following shareholder information to distribute fund materials—name, address, e-mail address, delivery preference, and the funds (CUSIPs) in which the investor holds shares. The intermediary also should ensure that the Regulatory Mailing List includes only

[78] 17 CFR 270.22c-2(c)(5).

[79] Funds already pay intermediaries sub-accounting fees to manage and maintain client account data. Any new rule therefore should make clear that the intermediary is responsible for revising any outdated or incorrect information in the data file.

[80] To promote direct communication between funds (and other issuers of securities) and their investors, the SEC has adopted rules to require intermediaries to provide funds, at their request, with lists of the names and addresses of investors who did not object to having such information provided to issuers, also referred to as NOBOs. *See* Exchange Act Rules 14b-1(b) and 14b-2(b). Exchange Act Rule 14a-13(b)(5) enables an issuer to obtain a list of its NOBOs only, which means that broker-dealers and banks must classify their beneficial owners as either objecting or non-objecting beneficial owners, based on the investor's election. A fund required or wishing to communicate with shareholders who hold fund shares through intermediaries can request that the intermediary provide the list of NOBOs to the fund so that it may do so. The fund then must reimburse the intermediaries for their reasonable expenses in preparing the NOBO list. *See* Rule 14a-13(b)(5). NYSE Rule 451.92 establishes a per-name fee that intermediaries can charge for preparation of the NOBO list.

[81] To address any intermediary' concerns about sharing customer information that could disadvantage them competitively, the SEC could require funds receiving this information to use it for no other purpose than mailing regulatory materials.

eligible accounts and excludes managed accounts that do not receive distributions of fund materials. Any fees associated with the generation of the Regulatory Mailing List should be reasonable and should not be reflective of the cost of maintaining any OBO or NOBO lists, which are separate products that funds purchase for use during proxy initiatives.

The Release asks with what frequency funds make requests for the names and addresses of NOBOs.[82] We understand that funds currently purchase the NOBO list only for proxy distributions, despite the list's limitations, where the need for the fund to reach a quorum outweighs the high cost of obtaining the NOBO list.[83]

The Release also asks whether the current NYSE NOBO fee structure discourages funds from sending fund materials to NOBOs directly.[84] Funds currently do not send fund materials to NOBOs directly because the list lacks needed information, and the NYSE-set fee for obtaining the NOBO list is too high. The NOBO list does not include OBOs, which represent the majority of intermediary-held accounts.

NOBO fees are another area in which our members believe that current fees far exceed what should be considered "reasonable" and deserve further scrutiny. The NYSE fee schedule sets a fee of 6 ½ cents per NOBO name provided to a requesting issuer.[85] If the intermediary designates an agent (*i.e.*, vendor) to provide the NOBO list, the issuer must pay an additional fee to the vendor as follows: 10 cents per name for the first 10,000 names; 5 cents per name for additional names up to 100,000 names; and 4 cents per name above 100,000. ICI members have raised concerns, for example, about (1) the level of fees charged given the relatively uncomplicated nature of the work involved and (2) the possibility that issuers may be paying twice for the same information.[86]

The current NOBO list only provides limited details—fund shareholder name, address, and telephone number. The list does not include e-mail address or delivery preference—information that is necessary for distribution of fund materials. It also does not list any other funds in which the shareholder is invested. This information is needed to consolidate shareholder mailings wherever possible.

Most importantly, as the name suggests, the "NOBO list" does not include OBOs. Most investors who hold fund shares in intermediary-held accounts are OBOs and may be contacted only

[82] *See* Release, *supra*, at p. 14.

[83] There are additional issues with obtaining the NOBO list in a proxy context. For example, we understand that intermediaries generally do not permit funds to pay per account record to obtain only the top owners in the fund. Instead, funds must purchase the whole NOBO list.

[84] *See* Release, *supra*, at p. 14.

[85] NYSE Rule 451.92.

[86] We noted in a prior comment letter that one member reported having received a quote of $135,000 for 1.3 million shareholders, or approximately 10.4 cents per name. Assuming that this figure includes the 6.5 cent per name intermediary fee, the vendor's fee appears to represent an additional 60 percent charge. *See* ICI March 2013 Letter, *supra*, at n.19.

through the intermediary (or its agent, such as the fulfillment vendor) that has the relationship with and is servicing the investor.[87] The SEC has estimated that OBOs hold 52 to 60 percent of all shares. In 2010, we estimated fifty-two percent of fund shares held in street name are owned by shareholders who have indicated that issuers may not contact them.[88] We expect that the OBO figures for fund shareholders have increased significantly since then. A significant portion of mutual fund shares are held through intermediaries, and it is our understanding that intermediaries generally default their customers to OBO status, resulting in a high number of OBOs.[89]

The Release asks whether low percentages of NOBOs relative to all fund beneficial owners would be a disincentive to requesting the NOBO list.[90] The low percentage is a disadvantage, however, the main disincentives to requesting the NOBO list for distributing fund materials are that the NOBO list does not include needed information, is expensive, and does not cover all beneficial owners.

More generally, the OBO/NOBO distinction is outdated and does not serve fund shareholders.[91] The existing NOBO/OBO structure was enacted in the early 1980s, at a time when roughly 25 percent of shares were held through beneficial accounts. Over three decades later, those numbers have essentially flipped, and the regulations have failed to adapt, despite overwhelming issuer support for reforming the rules.[92]

C. Realigning disconnect will reintroduce competition and alleviate the need for a fee schedule

The NYSE fee schedule is not needed when funds hire fulfillment vendors to deliver materials to their direct accounts. On the direct side, a number of vendors compete for funds' fulfillment business. If the SEC permits funds to select the vendor for delivery of fund materials for all accounts, we expect that funds would be able to negotiate lower prices for delivery, similar to the lower prices that they negotiate for their direct-held accounts.

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[87] *See Concept Release on the U.S. Proxy System*, SEC Rel. No. 3462495 (July 14, 2010), at p. 67, *available at* https://www.sec.gov/rules/concept/2010/34-62495.pdf

[88] *See* ICI 2010 Letter, *supra*, at n.6.

[89] We also understand that non-broker-dealer intermediaries now default their customers to OBO status following the enactment of privacy legislation in California and Massachusetts.

[90] *See* Release, *supra*, at p. 14.

[91] Funds have heightened problems in achieving quorums because of their disproportionately large retail shareholder base. *See* ICI 2010 Letter, *supra*. Obtaining a quorum can be extremely difficult and expensive for retail-oriented funds. The OBO/NOBO distinction therefore creates significant issues for funds in the proxy distribution context since it hampers investment companies' efforts to communicate with the large number of retail shareholders that purchase fund shares through intermediaries and choose the OBO designation.

[92] An analysis of comment letters the SEC received in response to its 2010 Proxy Concept Release found that more than 98 percent of issuers support reforming/eliminating NOBO/OBO. *See White Paper: Comment letters on proxy reform show strong support for change*, The Securities Transfer Association, Inc., *available at* https://www.sec.gov/comments/s7-14-10/s71410-281.pdf.

D. Transferring distribution of fund materials to sub-accounting would disadvantage small funds

The Release asks whether the costs of distributing fund materials is covered by administrative services, recordkeeping, or other similar contractual arrangements.[93] It is common for funds' shareholder servicing agreements with intermediaries to reference the intermediaries' obligation to distribute fund regulatory materials. The Rule 14b-1 framework and the NYSE fee schedule, however, govern the level of reimbursement for these distributions.

The Release also asks whether, if the fee schedule did not apply in such cases, whether the costs of distributing fund materials would increase or decrease.[94] If the SEC interpreted the fee schedule to no longer apply, and instead sought to shift delivery of fund materials to fall within intermediaries' shareholder servicing activities, funds and intermediaries would need to negotiate any changes, which may lead to increased sub-accounting payments. Such a negotiation likely would disadvantage smaller fund complexes who may lack bargaining power with large intermediaries.

## VI. If SEC Retains Existing Fee Framework, Fee Schedule Must Be Reworked to Reflect Reasonable Expenses

The Release asks whether the current fee and remittance structure for the distribution of fund materials is reasonable.[95] We do not believe it is reasonable. If the SEC chooses to retain the existing fee framework, it therefore must rework the fee schedule to reflect actual delivery costs, eliminate unreasonable vendor billing practices that drive up fund costs, and ensure robust regulatory oversight and regular review of fee rates and vendor billing practices.

We recommend the following steps to achieve this:

- Create a fee schedule for funds that is separate from the existing NYSE fee schedule, recognizing that the fees for forwarding of fund materials to intermediary-held accounts are unrelated to the fees for forwarding of operating company proxy materials;
- Replace the existing fees and layered application structure with simple flat fees that reflect actual costs, using cost for direct shareholders as a guide;
- Clarify that funds cannot be charged processing fees for managed accounts where funds are not required to forward materials and reimbursement is therefore unnecessary;
- Eliminate unreasonable billing practices, such as remittances, that maximize intermediary and vendor profit at fund shareholder expense;
- Create a robust regulatory oversight framework; and
- Mandate regular independent review of fee rates and vendor billing practices.

[93] *See* Release, *supra*, at p. 22.

[94] *See id.*, at p. 22.

[95] *See id*, at p. 13.

A. Create a fee schedule for funds that is separate from the existing NYSE fee schedule, recognizing that the fees for forwarding of fund materials are not analogous to the fees for forwarding of operating company proxy materials

Fund fees should be separated out from operating company fees into a new fund-only fee schedule.[96] The NYSE fee schedule was developed for the distribution of operating company proxy materials and does not contemplate distribution of fund materials.[97] Applying operating company proxy fees in the context of distributing fund materials creates additional expense for fund shareholders that bears no relation to actual cost.[98]

Providing funds with a separate schedule is necessary for funds to have a meaningful voice in the fee-setting process. NYSE historically has focused on the impact of the fees on operating companies, which are its constituency and area of expertise.[99] As a result, funds' concerns have gone unaddressed.[100]

Separating fund fees from the operating company fee schedule is necessary to allow for meaningful oversight and a more effective analysis of how these fees relate to the actual cost of the work being done for funds. Although the overall *cost of delivery* may have decreased as a result of the shift to e-delivery and the corresponding decrease in print and mail costs, the cost of the NYSE "processing fees" that apply to funds continues to rise (*e.g.*, e-delivered materials charged additional processing fees, all managed accounts charged processing fees beginning in 2013). In the meantime, NYSE has never performed an independent review of the fees and has not adjusted the fee schedule to account for technological advances or vendor economies of scale.[101]

B. Replace the existing layered fees with simple flat fees that reflect actual costs

We recommend replacing the existing fees and layered application structure with simple flat fees that reflect actual costs, using cost for direct shareholders as a guide. Funds are not opposed to reimbursing vendors or intermediaries for reasonable expenses. The current fees, however, are

[96] The Release asks whether the current rules regulating processing fees for distributing materials to beneficial owners should apply to forwarding fund materials. *See id.*, at p. 12.

[97] *See supra* Section III.A for further detail.

[98] *See supra* Section III.B for further detail.

[99] *See supra* Section III.A and *infra* Section VI.E.

[100] *See supra* Section III.A. *See also* Letter from Dorothy M. Donohue, Deputy General Counsel, ICI to Elizabeth M. Murphy, Secretary, SEC, dated Jun. 20, 2013, *available at* https://www.sec.gov/comments/sr-nyse-2013-07/nyse201307-37.pdf ("ICI June 2013 Letter"); ICI March 2013 Letter, *supra*; and ICI 2010 Letter, *supra*.

[101] This is a perennial issue dating back to the SEC's 1997 approval of the NYSE fee schedule pilot. *See* SEC 1997 Order, *supra*, at 13925 ("One commenter also argues that advancing technology should reduce, not increase, servicing costs, and that the increasing level of beneficial ownership should reduce, not increase, per unit servicing costs.").

based on an operating company paradigm that bears no relation to actual expenses in the fund context.[102]

We therefore recommend that the SEC eliminate the existing processing unit fee, preference management fee, and notice and access fee, as well as any layering of the fees. The SEC should undertake an independent review of the fees and create a new reimbursement schedule for forwarding fund materials with separate flat fees for mail, e-mail, and Rule 30e-3 Notices (using cost for direct shareholders as a guide). This would eliminate the layering of fees and the lack of transparency in how vendors are applying the fees. It also would represent further progress toward closing the gap between the costs that funds pay for direct-held accounts and the costs that funds pay for delivering fund materials to intermediary-held accounts.

C. Clarify that funds cannot be charged processing fees for managed accounts where funds are not required to forward materials

The Release asks whether the current application of processing fees for distribution of fund materials to managed account investors is appropriate and whether managed accounts should be eligible for different treatment under the current fee structure.[103] The current application of these fees is inappropriate, and we urge the SEC to clarify that funds cannot be charged processing fees for delivery of fund materials to shareholders invested through managed accounts, where those shareholders have delegated proxy voting and receiving shareholder mailings to the professional advisor ("Managed Accounts").[104] Appendix B provides additional background, including how NYSE's 2013 amendments to the fee schedule significantly increased the fees that funds can be charged for Managed Accounts.

The Commission has made clear that funds have ***no*** regulatory responsibility to deliver fund materials to Managed Account investors that have delegated voting authority.[105] Because the

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[102] *See supra* Section II.B. (showing cost of delivery of fund materials to direct-held accounts).

[103] *See* Release, *supra*, at p. 20.

[104] NYSE rule 451.90(6) defines a "managed account" as "an account at a nominee which is invested in a portfolio of securities selected by a professional advisor, and for which the account holder is charged a separate asset-based fee for a range of services which may include ongoing advice, custody and execution services." As background, many intermediaries sponsor managed account programs for investors who seek to delegate investment discretion to an investment adviser. In most cases, these are investors who lack the expertise, time, or interest to manage their own investments directly. A fully-diversified discretionary account may include hundreds of investment positions. These investors generally prefer not to receive what could be a substantial volume of fund disclosure materials, especially for investments they are not selecting themselves.

The intermediary has no delivery obligation to the beneficial owner; the delegation of voting proxies and receiving shareholder mailings is a natural feature of the managed account. The NYSE rules now use the term "wrap account" interchangeably with "managed account" for purposes of processing fees. *See* SEC October 2013 Order, *supra*, at p. 21.

[105] Rule 3a-4 under the Investment Company Act provides a safe harbor for managed accounts from the definition of investment company. In the adopting release, the Commission stated that "…if a client delegates voting rights to another person, the proxies, proxy materials, and, if applicable, annual reports, need be furnished only to the party exercising the delegated voting authority." *Status of Investment Advisory Programs Under the Investment Company Act of 1940*, SEC Rel. No. IC-22579; IA-1623, 1997 SEC LEXIS 673, at 47 (Mar. 24, 1997).

fund has no delivery obligation to a Managed Account shareholder, there are no materials for the intermediary to forward and no delivery expenses for which the fund needs to reimburse the intermediary. Despite this, funds are charged for delivering materials that have not been delivered—and should not have been delivered in the first place. We urge the SEC to prohibit this abusive practice.[106]

*1. Assessing processing fees to Managed Accounts for delivery of fund materials is inappropriate*

The predominant fulfillment vendor commonly charges a fund two separate processing fees—a processing unit fee and a preference management fee—for each Managed Account, each time a fund releases a shareholder report, prospectus, or any other material required to be distributed to shareholders.

We urge the SEC to clarify that funds cannot be charged the following processing fees in connection with *not* sending fund materials to Managed Accounts.

a. 15 cent processing unit fee

As we discuss in Section III.C.2, the processing unit fee is charged for each account record in the shareholder position file that the intermediary transmits to the vendor. Intermediaries should not include Managed Account records in the files transmitted to vendors for purposes of distributing fund materials. Vendors effectively charge funds tens of millions of dollars annually for "reading" an account record that they should not receive in the first place.

Instead, any processing or programming functions necessary to segregate these accounts for purposes of receiving fund materials should take place at the intermediary level prior to transmitting any account information to the fulfillment vendor. Intermediaries that sponsor these discretionary Managed Account programs already charge investors asset-based fees that cover shareholder services and should include any expense associated with segregating Managed Account records as a cost of operating the account on behalf of the investor.

[106] We note that similar concerns have been raised about the practice of charging corporate issuers proxy processing fees for managed accounts, even though there is no regulatory requirement for those accounts to receive a proxy. *See* Letter from Karen V. Danielson, President, Shareholder Services Association, and Charles V. Rossi, President, The Securities Transfer Association, Inc. (STA), to Elizabeth M. Murphy, Secretary, SEC, dated Mar. 12, 2012, *available at* http://www.stai.org/pdfs/2012-03-12-sta-ssa-joint-letter.pdf ("STA/SSA 2012 Letter"). The STA filed a formal complaint with FINRA on this issue on October 31, 2011. *See* Letter from Charles Rossi, President, The Securities Transfer Association, to Richard G. Ketchum, Chairman and Chief Executive Officer, Financial Industry Regulatory Authority, dated Oct. 31, 2011, *available at* http://www.stai.org/pdfs/2011-10-ketchum-letter.pdf. Marc Menchel, FINRA's General Counsel, responded on January 23, 2012. *See* STA/SSA 2012 Letter, at p. 16 (stating that FINRA has the authority to address these issues, but that "FINRA rules have historically bowed to those of the NYSE, to the extent possible, because FINRA does not have issuer registrants and consequently these matters have historically been dealt with by the NYSE as they reside in the core of their operations as a SRO"). STA also filed a complaint with NASDAQ on November 9, 2011. *See* Letter from Charles Rossi, President, The Securities Transfer Association, to Robert Greifeld, Chief Executive Officer and President, The NASDAQ OMX Group, dated Nov. 9, 2011, *available at* http://www.stai.org/pdfs/2011-11-sta-letter-to-robert-greifeld-nasdaq.pdf.

b. 10 cent preference management fee

The underlying regulatory purpose of permitting vendors and intermediaries to charge the preference management fee is to reimburse the intermediary's efforts to track the shareholder's delivery preference—a justification that does not apply in the managed account context. A managed account is an account type, not a delivery preference that the shareholder can change from time to time.

The 2013 SEC Order was silent on the issue of managed accounts in the context of forwarding fund materials.[107] In discussing managed accounts in the proxy context, however, the 2013 SEC Order compared a broker's effort to maintain this account "type" (*i.e.*, managed account) to the effort necessary to maintain the beneficial owner's delivery preference (*e.g.*, e-delivery and householding), and thus deemed this charge reasonable.[108] This analogy, however, is inapt. Tracking an account "type" is operationally different from tracking a delivery preference.[109]

In 2007, a senior FINRA executive publicly agreed with our view that intermediaries should not charge processing fees for Managed Accounts, clearly stating that "broker-dealers should not be forwarding the names of [separately managed account] investors to the issuers or their service providers."[110]

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[107] The SEC's order approving the 2013 NYSE fee schedule amendments discussed managed accounts in the context of delivering operating company proxies. NYSE sets the maximum preference management fees for managed accounts at a rate that is half that of preference management fees for other types of accounts. Halving the fee was supposed to allow for issuers and brokers to share the cost of "the admittedly real processing work that is done to track and maintain the voting and distribution elections made by the beneficial owners of the stock positions in the managed account." SEC October 2013 Order, *supra*. The SEC noted NYSE's assertion that "tracking the beneficial owner's voting and distribution election is as necessary with Managed Accounts as it is with any other proxy distribution election eliminating the need for paper mailing, such as consent to e-delivery." *Id.*

Beneficial owners do not change their voting and distribution election, however, as a practical matter. Rather, we understand that voting and distribution delegation is typically hard-wired into investment management agreements, especially for the retail products that account for the majority of managed accounts.

[108] *Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change Amending NYSE Rules 451 and 465, and the Related Provisions of Section 402.10 of the NYSE Listed Company Manual, which Provide a Schedule for the Reimbursement of Expenses by Issuers to NYSE Member Organizations for the Processing of Proxy Materials and Other Issuer Communications Provided to Investors Holding Securities in Street Name, and to Establish a Five-Year Fee for the Development of an Enhanced Brokers Internet Platform*, SEC Rel. No. 34-69622 (May 23, 2013), at p. 51-52, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-69622.pdf.

[109] Account "type" is determined at account opening based on customer direction regarding registration of the account and the level of advisory services (*i.e.*, how much discretion the broker is allowed regarding investment decisions) to be provided by the broker-dealer. Account "type" generally does not change. The broker's recordkeeping system typically uses the account "type" designation to drive a number of functions and services provided to the customer, including tax reporting and statement delivery. In contrast, a shareholder's delivery preference is tracked by simply recording a "yes/no" indicator on the account. Shareholder delivery preference may evolve over time and is used to track, among other things, householding and summary prospectus delivery elections.

[110] *See* STA/SSA 2012 Letter, *supra*, at p. 3 (addressing a SIFMA symposium on proxies).

At least one major broker-dealer also appears to agree and does not include managed account records when it sends its data files to the predominant vendor for shareholder report delivery.[111]

Anecdotally, some of ICI's members have spoken to their distribution partners about the inappropriate inclusion of Managed Accounts in the data files that the intermediaries transmit to the vendor. Some of these intermediaries then have attempted to remove Managed Accounts from the data file they send to the vendor. We understand that, in at least one case, the vendor informed an intermediary that the intermediary is contractually required to include these Managed Accounts in the data that it sends to the vendor.

We therefore recommend that the SEC clarify that funds cannot be charged processing fees in connection with not sending fund materials to Managed Accounts.

### D. Eliminate unreasonable billing practices that maximize intermediary and vendor profit at shareholder expense

We recommend the SEC address the following unreasonable billing practices that have developed under the NYSE schedule:

- **Billing the maximum rate**. Clarify that funds are reimbursing intermediaries for reasonable expenses incurred.
- **"Remittances."** Ban "remittances" from vendors to intermediaries.
- **Postal aggregation discounts**. Clarify that postal aggregation discounts belong to the fund and its shareholders and should be credited to the fund as they are for direct-held accounts.
- **Vendor invoice detail and transparency**. Require vendor invoices to provide transparency into all charges, including postal aggregation discounts that funds should receive, remittances that the vendor pays to each intermediary, information about how fees are layered, and explanations or justifications for why fees are charged or how they are applied.

#### *1. Billing the maximum NYSE fee rate does not represent reasonable cost*

The SEC must clarify that, as expressly provided for in the Section 14 rules, funds are *reimbursing* intermediaries for expenses incurred and those expenses must be reasonable. The NYSE fee schedule sets a cap on the maximum "reasonable" reimbursement that intermediaries can charge funds for "processing" of forwarding materials.[112] Funds are almost always charged this maximum rate, as intermediaries lack the incentive to negotiate a lower rate with the vendor

[111] *See* STA/SSA 2012 Letter, *supra*, at p. 13.

[112] Funds additionally must provide reimbursement for out-of-pocket costs, such as the printing and postage cost for a mailed shareholder report.

on behalf of fund shareholders. Moreover, even when intermediaries negotiate a lower rate, funds are charged the maximum rate.

#### 2. *"Remittances" inappropriately transfer fund assets to intermediaries*

We urge the SEC to ban the practice of "remittances" as an inappropriate and unacceptable transfer of fund assets to intermediaries.[113]

In situations where an intermediary has negotiated processing fees that are lower than the NYSE maximum processing fee, the vendor typically does not charge the fund the negotiated rate. Instead, the vendor invoices the fund for the maximum NYSE fee rate, and then "remits" the difference back to the broker. The concept of "remittances" entirely ignores the fact that the intermediary is negotiating the price on behalf of the fund. When funds negotiate with vendors on behalf of their direct-held accounts, the fund pays the negotiated rate.

The Release asks to what extent intermediaries receive remittances or rebates from fulfillment vendors for non-proxy deliveries.[114] Intermediaries and vendors do not provide information to funds about the existence or amount of these payments. Funds are aware of these remittances as a result of their discussion in past NYSE fee reviews.

NYSE and the SEC last justified these "remittances" or "cost recovery payments" in 2013 as a rational side effect of a "one size fits all" fee structure, where some intermediaries are "winners" and some intermediaries are "losers."[115] In other words, NYSE and the SEC assumed that the vendor would charge some intermediaries—the "losers"—an amount that would exceed the reimbursement those intermediaries were able to collect from the funds. It is our understanding that this scenario does not happen in practice. Logic would lead to the conclusion that if the vendor charged any intermediary an amount that exceeded the reimbursement the intermediary collected from the fund, the intermediary simply would seek out another vendor. Additionally, while some assert that remittances reimburse intermediaries for additional work performed, it is our understanding that the intermediary's involvement in the mailing process is minimal or nonexistent.[116]

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[113] The Release asks whether the current fee and remittance structure for the distribution of fund materials to investors is reasonable. *See* Release, *supra*, at p. 13.

[114] *See id.*, at p. 17.

[115] *See* ICI 2016 Letter, *supra*, at p. 44-45.

[116] In reviewing these "remittances" in 2013, the SEC and NYSE also considered data from a SIFMA survey of 15 brokers where "[t]he firms provided information about the costs they incur as part of the proxy distribution process." Letter from Janet McGinness, EVP and Corporate Secretary, NYSE Euronext, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission, dated July 9, 2013, available at https://www.sec.gov/comments/sr-nyse-2013-07/nyse201307-44.pdf, at p. 4-5. The survey concluded that "costs incurred by [SIFMA] members beyond the cost of outsourcing activities to Broadridge is consistent with the aggregate amounts paid by Broadridge to the brokers in 'cost recovery payments.'" *See* Exhibit 2 to SEC February 2013 Notice, *supra,* at, p. 5, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-68936-ex2.pdf. This survey focused solely on the proxy process, however, and did not break out mutual funds separately from corporate issuers.

The Release asks what, if any, additional related costs intermediaries incur in connection with non-proxy distributions.[117] It seems highly improbable that intermediaries are incurring expenses for distributing fund materials beyond what they pay the vendor, when the typical fund is paying more than three times as much for delivery of a shareholder report to an intermediary-held account as compared to a direct-held account.

*3. Funds should receive the benefit of postal aggregation discounts*

The SEC should clarify that postal aggregation discounts belong to the fund and its shareholders and should flow back to the fund as they do on the direct side. For direct-held accounts, the vendor charges the fund for actual postage cost, which includes any postal aggregation discounts. For intermediary-held accounts, we understand that vendors charge the fund the cost of postage before any aggregation discounts and then retain most of the discounts.

*4. Vendor invoices lack transparency and are overly complex*

We recommend the SEC require increased transparency of the invoices that vendors send to funds in several respects to reform today's complex and opaque vendor invoices.[118]

Our members find that vendor invoices reflect postage costs, but do not reflect the savings that a fund should receive from postal aggregation discounts. The vendor's postal charges should include postal aggregation discounts that the fund should receive, and the invoice should show these discounts.

The Release asks whether intermediaries inform funds as to the amounts and related costs and services associated with remittances they receive.[119] Vendor invoices do not reflect any intermediary remittances, and vendors and intermediaries do not otherwise provide funds with information about the existence or amount of any remittances or what, if any, services the remittances cover.

As we describe in Section III.C.4, the fee schedule allows vendors to layer processing fees in a manner that significantly increases their overall cost. Vendor invoices do not provide insight into how fees are layered.

Vendor invoices do not explain or justify in any way why fees are charged or how they are applied. Interpretation of the NYSE fee schedule can be opaque and subjective, especially since the NYSE rules do not explicitly reference fund materials. Without any meaningful oversight

[117] *See* Release, *supra*, at p. 17.

[118] The Release asks whether intermediaries and the vendors they hire provide funds with sufficiently detailed and transparent invoices for processing fees assessed on distributions of fund materials. *See* Release, *supra*, at p. 13. NYSE rule 465.30 provides for the form of a billing document to be used by its members to seek reimbursement. For each category of distribution, such as interim materials, the invoice must specify the number of reports mailed, the service fee, the number of envelopes not supplied by the issuer used, the U.S. postage, the foreign postage, the cost of mail, and the total cost assessed.

[119] *See* Release, *supra*, at p. 17.

from intermediaries or NYSE, vendors are free to apply the fee schedule in ways that run counter to the intent of the reimbursement framework, while technically falling within the bounds of NYSE rules.

E. Create a robust regulatory oversight framework

If the SEC retains the fee schedule and existing reimbursement system, it will need to ensure robust oversight over the disconnect in permitting intermediaries to negotiate the fees that funds pay. We therefore recommend that the SEC take ownership of the fee schedule and establish an advisory committee with a balanced membership and access to data around actual cost.

The SEC originally delegated determination of reasonable expenses to SROs because it believed that SROs would be best positioned to fairly evaluate and allocate the costs of distributing shareholder materials.[120] The SEC believed that SRO exchanges would act as "representatives of both issuers and brokers."[121] NYSE acts as a representative of corporate issuers and intermediaries, but does not represent funds and lacks regulatory interest in this area.[122]

The Release asks whether FINRA should be the SRO for setting the structure and level of processing fees for funds.[123] Although FINRA would be a better overseer than NYSE, it is not the most effective option.[124] FINRA represents broker-dealers, not fund shareholders.

Consequently, we urge the SEC to take ownership of the fee schedule. The SEC could establish an advisory committee similar to the NYSE-formed PFAC, but with a more balanced membership and access to unbiased data on actual cost. Any advisory committee should represent both funds and intermediaries. It also should rely on data from an independent review of the fees and the actual costs of the services provided, rather than relying on vendors to perform their own analysis of reasonable cost.

F. Mandate regular review of fee rates and vendor billing practices

The SEC should immediately engage an independent third party to comprehensively review the processing fees that funds are charged for delivery of fund materials. An independent review also

[120] *See* SEC 1997 Order, *supra*.

[121] *Id*.

[122] More recently, NYSE has observed that it "has no involvement in the mutual fund industry" and that it "may not be best positioned to take on the regulatory role in setting fees for mutual funds." *See* SEC 2016 Notice, *supra*, at p. 4.

[123] *See* Release, *supra*, at p. 15.

[124] We previously have asked the SEC to move oversight of the fee schedule from NYSE to FINRA. *See* Letter from David W. Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, SEC, dated Sept. 12, 2016, *available at* https://www.sec.gov/comments/sr-nyse-2016-55/nyse201655-4.pdf. We recognize, however, that FINRA represents broker-dealers and may not be well positioned to represent both funds and intermediaries in an objective and even-handed manner.

should occur every three years to ensure that fees are evaluated in step with new regulations and/or process innovations.[125]

The relationship between the amount of the fee and the actual cost of the work has never undergone independent third-party review despite various issuer requests, including from ICI, over the past two decades.[126]

If the fee schedule remains in place and the underlying disconnect is not resolved, we emphasize that these fees and their application will need regular review to address new issues that arise as vendors seek to retain existing profit margins and intermediaries continue to lack incentive to negotiate lower fees for funds.

*        *        *

[125] The last review of the NYSE fee schedule included a recommendation to undertake a comprehensive review of the fees every three years. *See* SEC February 2013 Notice, *supra*, at p. 48.

[126] *See* SEC 1997 Order, *supra*; *Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Its Rules Regarding the Transmission of Proxy and Other Shareholder Communication Material and the Proxy Reimbursement Guidelines*, SEC Rel. No. 34-45644 (Mar. 25, 2002), *available at* https://www.sec.gov/rules/sro/34-45644.htm; SEC October 2013 Order *supra*, at p. 30.

We appreciate the opportunity to provide comments in response to the SEC's request for comment on the framework for the fees that funds are charged for delivery of fund materials to intermediary-held accounts. If you have any questions, please contact me ([redacted] or [redacted]), Dorothy Donohue, Deputy General Counsel—Securities Regulation ([redacted] or [redacted]), Linda French, Assistant Chief Counsel ([redacted] or [redacted]), or Joanne Kane, Director, Operations & Transfer Agency [redacted] or [redacted]).

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel

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

Dalia O. Blass
Director, Division of Investment Management

Brett W. Redfearn
Director, Division of Trading & Markets

## Appendix A

## NYSE Fee Schedule: History of Development

For many years, the SEC has relied on self-regulatory organizations (SROs) under its jurisdiction to establish the fees that issuers must pay to reimburse intermediaries for proxy processing and distribution services.[127] The SEC believed that SROs would be best positioned to fairly evaluate and allocate the costs associated with the distribution of shareholder materials.

Historically, NYSE has taken the lead in establishing the proxy fee structure for broker-dealers, banks, and issuers. It initially created the fee schedule for the distribution of operating company proxy materials.[128] This proxy fee structure now also applies to distribution of fund materials. This application is an accident of history that does not reflect the intended purpose of the fees. The Financial Industry Regulatory Authority (FINRA), the SRO for broker-dealers, and the NASDAQ Stock Market (NASDAQ) have adopted rules mirroring the NYSE framework.[129] The SRO rulemaking process established this fee structure, which the SEC approved, pursuant to Section 19(b) of the Exchange Act.[130]

In 1997, the SEC approved a one-year NYSE pilot program that would change the guidelines for intermediaries reimbursing issuers for expenses related to processing of proxy materials and other issuer communications sent to intermediary-held accounts.[131] This pilot program did not contemplate whether or how the reimbursement guidelines would apply to forwarding of *fund* materials to intermediary-held accounts.

The Commission approved the NYSE reimbursement guidelines in 2002.[132] The approval required NYSE to periodically review the fees to ensure that they were related to the reasonable proxy expenses of NYSE member firms.[133] As in 1997, the approval noted the SEC's belief that "ultimately market competition should determine reasonable rates."[134] The NYSE proposal and

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[127] *See* SEC Rel. No. 34-21900, 50 Fed. Reg. 13,297 (Apr. 3, 1985) ("In adopting the direct shareholder communications rules the Commission left the determination of reasonable costs to the SROs, because, as representatives of both issuers and brokers, they were deemed to be in the best position to make a fair allocation of the costs associated with the amendments, including start-up and overhead costs.").

[128] The NYSE rule setting forth the fee schedule is titled "Schedule of approved charges by member organizations in connection with proxy solicitations." *See* NYSE rule 451.90.

[129] *See* NYSE Rules 451 and 465, and section 402.10 of the NYSE Listed Company Manual; NASDAQ Rule 2251; and FINRA Rule 2251.

[130] 15 U.S.C. § 78s(b).

[131] *See* SEC 1997 Order, *supra*.

[132] *See Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the New York Stock Exchange, Inc. Amending Its Rules Regarding the Transmission of Proxy and Other Shareholder Communication Material and the Proxy Reimbursement Guidelines*, SEC Rel. No. 34-45644 (Mar. 25, 2002), *available at* https://www.sec.gov/rules/sro/34-45644.htm.

[133] *Id.*

[134] *Id.* ("While the Commission today has determined to approve the Pilot Program on a permanent basis, the Commission continues to believe that ultimately market competition should determine reasonable rates and expects the NYSE to continue its ongoing review of the proxy fee process, including considering alternatives to SRO standards that would provide a more efficient, competitive, and fair process. . . . The Commission believes that

SEC approval did not contemplate whether or how these fees would apply to forwarding of fund materials.

Although NYSE did not formally review the fees again until 2010, a NYSE working group issued a report in 2006, strongly recommending a periodic, independent review of the structure and amount of processing fees as follows:

> The Proxy Working Group therefore recommends that the NYSE should periodically re-evaluate the fees structure to ensure that no entity is unduly profiting off the current system. Issuers and shareholders deserve periodic confirmation that the system is performing as cost-effectively, efficiently and accurately as possible, with the proper level of responsibility and accountability in the system.
>
> To achieve these objectives, the Proxy Working Group recommends that the NYSE engage an independent third party to analyze what is a 'reasonable' amount for issuers to be charged pursuant to Rule 465 and to conduct cost studies of the current services provided by [the predominant vendor] and commission an audit of [vendor] costs and revenues for proxy mailing. These studies and audit should include a detailed review of [the vendor's] actual and anticipated future costs, especially in light of the new electronic delivery proposal by the SEC. The NYSE should disclose the findings of these regular reviews to a Sub-Committee of the Working Group before instituting any changes to the current fees.
>
> The Working Group also recommends that the NYSE review [the vendor's] contract arrangements with brokers. It is understood that these contracts are designed to cover the brokers' costs of providing information about beneficial owners to [the vendor], but since the reimbursement is tied to the fees regulated by the NYSE, they should be carefully reviewed to make sure that these agreements are not covering other costs unrelated to beneficial owner information.[135]

In September 2010, NYSE formed the Proxy Fee Advisory Committee (PFAC) (composed of issuers, broker-dealers, one mutual fund company, and NYSE representatives) to review the existing structure for reimbursement fees that issuers pay for the distribution of proxy materials to investors who invest through intermediary-held accounts.[136] The PFAC began its review in conjunction with the SEC's concept release on the proxy system, issued in July 2010.[137]

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permanent approval of the current proxy fee structure will permit the NYSE and other interested parties to focus on a long-term solution that would allow market forces rather than SRO rules to set rates.). The Commission made similar statements in its 1997 order approving the pilot program. *See* SEC 1997 Order, *supra*, at 13930.

[135] New York Stock Exchange, *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006), at p. 28, *available at* http://www.shareholdercoalition.com/sites/default/files/NYSE%20Proxy%20Working%20Grp%20Rpt%206-5-2006.pdf.

[136] *See* SEC October 2013 Order, *supra*, at p. 7.

[137] *Concept Release on the U.S. Proxy System*, SEC Rel. No. 3462495 (July 14, 2010), *available at* https://www.sec.gov/rules/concept/2010/34-62495.pdf.

ICI provided comments on the SEC's 2010 concept release, expressing a number of concerns with the existing fee framework and recommending that the Commission:

- conduct an independent third-party audit of the current fee structure to establish reasonable rates of reimbursement;
- assess the reasonableness of the rates periodically thereafter; and
- work toward the establishment of a more competitive marketplace for the distribution of proxy materials.[138]

We also asked the SEC to focus on giving issuers the flexibility to choose providers to deliver their materials, since this should accelerate the development of a more competitive marketplace, which in turn would help rationalize fees and increase transparency."[139]

The PFAC released a report in May 2012 with several recommendations for the NYSE on the existing proxy distribution fee structure. [140] The report additionally highlighted differences between processing fees charged to mutual funds (*e.g.*, fees paid by mutual funds for shareholder report delivery) and operating companies, but did not recommend changes to the fees charged for distributing fund materials.[141] The PFAC's recommendations were not based on an independent review of actual cost. The recommendations instead relied on public information about vendor profitability as well as the vendor's own analysis of whether the NYSE fees aligned with its work effort.[142]

Following the PFAC report, NYSE convened the Mutual Fund Working Group to follow up on the PFAC's recommendations to look at aspects of the proxy fees as they related to mutual funds, including whether they should apply to distribution of fund shareholder reports. The working group included representatives from mutual fund and broker-dealer firms and had a series of meetings beginning in December 2012, but was unable to reach consensus around any changes to the fees' impact on funds.[143]

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138 *See* ICI 2010 Letter, *supra*, at p. 7-10.

139 *See id.,* at p. 8.

140 *See* SEC February 2013 Notice, *supra*, at p. 8 (summarizing the PFAC report's conclusions).

141 *See id.*, at p. 47 ("The PFAC's recommended changes should have a relatively modest impact on mutual funds, and the PFAC did not recommend changes to the interim report fees, which are the ones most applicable to mutual funds.").

142 *See id*. at p. 11 ("The Committee also focused on whether the new recommended fees appear to be aligned with the work effort to which the fees relate. At the Committee's request, Broadridge analyzed the work effort across the several tasks involved in proxy distribution. The Committee observed that this analysis confirmed that fees and work effort appeared to be roughly in line."). *See also* SEC October 2013 Order, *supra* (noting that "the Commission questioned the rigor with which the PFAC and the Exchange reviewed the costs associated with proxy processing in developing its recommendations, and noted the PFAC's reliance on publicly available financial information about Broadridge that did not break out the proxy distribution business as a standalone segment, as well as related analyst reports").

143 *See* Letter from Scott R. Cutler, EVP, Head of Global Listings, NYSE Euronext, to Dorothy M. Donohue, Deputy General Counsel—Securities Regulation, ICI, dated Jan. 23, 2014 (summarizing the results of the Mutual Fund Working Group and noting that the group "did not develop any potential fee changes that were both acceptable to all constituents and that the group thought could have a significant impact on the distribution costs incurred by mutual funds and their investors").

In February 2013, the NYSE filed proposed rule changes with the SEC that would codify most of the PFAC's recommendations.[144] NYSE, in submitting the revised fee schedule to the SEC for approval, stated it believed that the changes would result in lower fees.[145] This representation appeared to be an important factor for the SEC in its approval of the revised fee schedule. NYSE based its representation on data from the predominant vendor and a small sampling of brokers, indicating that issuer-paid fees overall would decrease by approximately four percent and mutual fund-paid fees would be modestly affected.[146] NYSE also stated that "it would welcome a movement away from utilizing SRO rules to set the [fee schedule]."[147]

In comments on the NYSE's proposed rule changes, ICI reiterated its strong concerns with the current proxy distribution fee system and opposed several aspects of the proposal because it failed to create an incentive to reduce fees.[148] Our comment letter recommended an independent review of the actual costs of the current fee system and recommended changes to notice and access fees, preference management fees, and fees for obtaining a list of non-objecting beneficial owners.

In May 2013, the SEC issued an order to determine whether to disapprove the proposal.[149] ICI filed an additional comment letter reiterating the need for an independent review of the current fee structure, noting that NYSE historically has relied almost exclusively on vendor-provided data with very little outside information or analysis.[150]

The SEC approved the NYSE rule changes in October 2013 without addressing ICI's concerns.[151] The SEC's approval order barely mentioned mutual funds at all, other than to note commenters' concerns, in contrast to brokers' representations, that the update to the NYSE fee schedule "could result in a significant fee increase" in processing fees for mutual funds, particularly with respect to the processing fees charged for delivery of fund shareholder reports.[152] The Commission's order reiterated its desire to encourage market competition in this space.[153]

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[144] *See* SEC February 2013 Notice, *supra*.

[145] *Id.*

[146] *Id.*, at p. 47 (noting that "[the] recommended changes should have a relatively modest impact on mutual funds").

[147] *See id.*, at n.14.

[148] *See* ICI March 2013 Letter, *supra*.

[149] *See* SEC May 2013 Order*, supra.*

[150] *See* ICI June 2013 Letter, *supra*.

[151] *See* SEC October 2013 Order, *supra*.

[152] *See id.*, at p. 58-59. While the overall cost of printing and mailing has dropped, the increase in adoption of electronic delivery counterintuitively increases the processing fees that funds pay. We explain in Section III.C.2 how funds pay almost seventy percent more in processing fees to electronically deliver a shareholder report as compared to mailing that same report.

[153] *See id*. (noting that the Commission "continues to review the issues raised in the Proxy Concept Release, including ways to encourage competition in the proxy distribution process, so that more reliance can be placed on market forces to determine reasonable rates of reimbursement").

The NYSE-formed PFAC recommended revisiting the fee schedule in three years (*i.e.,* 2016) to ensure that the fees were operating as the predominant vendor represented.[154]

[154] *See id.*, at p. 48.

## Appendix B

## Managed Accounts: Background and History

Neither funds nor intermediaries are required to deliver fund materials to shareholders invested through managed accounts, where those shareholders have delegated proxy voting and receiving shareholder mailings to the professional advisor ("Managed Accounts").[155] Despite that, it is common practice for fulfillment vendors (acting on behalf of intermediaries) to charge funds two different types of processing fees under the NYSE fee schedule for each Managed Account. The vendor charges these fees each time the fund distributes shareholder materials. It is our understanding that this practice originated with the fulfillment vendor.

### 1. *Funds have no regulatory responsibility to deliver fund materials to Managed Accounts*

The Commission has made clear that funds have no regulatory responsibility to deliver fund materials to Managed Account investors. Rule 3a-4 under the Investment Company Act provides a safe harbor for managed accounts from the definition of investment company. In the adopting release, the Commission stated that "…if a client delegates voting rights to another person, the proxies, proxy materials, and, if applicable, annual reports, need be furnished only to the party exercising the delegated voting authority."[156]

In practice, the sponsor of these investment programs typically receives one copy of the shareholder materials on behalf of each fund in the Managed Account program.[157] Acting in its capacity as an investment adviser, the sponsor then reviews these disclosure documents in lieu of the beneficial owners, who have delegated investment discretion to the sponsor.

Despite this, fulfillment vendors have, for a number of years now, charged funds a series of processing fees for Managed Accounts at the beneficial owner level. Funds are charged these fees even though investors in these accounts are not receiving—or expecting to receive—fund disclosure documents such as prospectuses and shareholder reports.

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[155] NYSE rule 451.90(6) defines a "managed account" as "an account at a nominee which is invested in a portfolio of securities selected by a professional advisor, and for which the account holder is charged a separate asset-based fee for a range of services which may include ongoing advice, custody and execution services." As background, many intermediaries sponsor managed account programs for investors who seek to delegate investment discretion to an investment adviser. In most cases, these are investors who lack the expertise, time, or interest to manage their own investments directly. The delegation of voting proxies and receiving shareholder mailings is a natural feature of the managed account. A fully-diversified discretionary account may include hundreds of investment positions. These investors generally prefer not to receive what could be a substantial volume of fund disclosure materials, especially for investments they are not selecting themselves.

[156] *Status of Investment Advisory Programs Under the Investment Company Act of 1940*, SEC Rel. No. IC-22579; IA-1623 (Mar. 24, 1997).

[157] *Cf.* plan participants in employee benefit plans. *See* Rule 14b-1(c) under the Exchange Act.

2. *NYSE's 2013 amended definition of managed accounts increased fees for funds*

NYSE rules do not explicitly permit vendors to charge fees for Managed Accounts in the context of distributing fund materials. The rules explicitly permit these fees in the context of operating company proxy distributions, and vendors have interpreted this as permitting them to charge these fees also in the context of distribution of fund materials.

NYSE's 2013 amendments to the fee schedule expanded the definition of managed accounts to which vendors could apply processing fees. Prior to the SEC's 2013 order approving various changes to the NYSE schedule, vendors did not charge any processing fees for "wrap fee" accounts.[158] The 2013 amendments changed this, permitting vendors to charge processing fees for wrap accounts that hold more than five shares of an issuer.

NYSE anticipated the 2013 amendments would have a "relatively modest impact on mutual funds."[159] Instead of a "modest" impact, the expanded definition of managed accounts significantly increased the number of accounts subject to processing fees for distributing fund materials, including fund proxies.[160] One member estimates that the number of Managed Accounts subject to processing fees increased by 267% from 2012 to 2013, mostly as a result of the rule change.

3. *Current application of processing fees to Managed Accounts for delivery of fund materials is inappropriate*

It is common practice for fulfillment vendors to charge a fund two separate processing fees—a processing unit fee and a preference management fee—for each Managed Account that holds that fund, each time the fund releases a shareholder report or prospectus.

We therefore strongly recommend that the SEC clarify that funds cannot be charged the following processing fees in connection with *not* sending fund materials to Managed Accounts.

a. 15 cent processing unit fee

As discussed in Section III.C.2, the processing unit fee is charged for each account record in the shareholder position file that the intermediary transmits to the vendor. Intermediaries should not include Managed Account records in the files transmitted to vendors for purposes of distributing fund materials. Vendors effectively charge funds tens of millions of dollars annually for "reading" an account record that they should not receive in the first place.

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[158] *See* SEC October 2013 Order, *supra*. The NYSE rules now use the term "wrap account" interchangeably with "managed account" for purposes of processing fees. *See* SEC October 2013 Order, *supra*, at p. 2.1NYSE previously had exempted wrap fee accounts because it found that the added costs of applying fees to these relatively low balance accounts outweighed the benefits to an issuer of any increased voting participation. *See* SEC February 2013 Notice, *supra*.

[159] *See* SEC February 2013 Notice, *supra*, at p. 47.

[160] This change similarly increased the number of accounts subject to processing fees for distributing fund proxies.

Instead, any processing or programming functions necessary to segregate these accounts for purposes of receiving fund materials should take place at the intermediary level prior to transmitting any account information to the fulfillment vendor. Intermediaries that sponsor these discretionary Managed Account programs already charge investors asset-based fees that cover shareholder services and should include any expense associated with segregating Managed Account records.

b. 10 cent preference management fee

The purpose of the preference management fee is to reimburse the intermediary's efforts to track the shareholder's delivery preference—a justification that does not apply in the managed account context. A managed account is an account type, not a delivery preference that the shareholder can change from time to time. The 2013 SEC Order was silent on the issue of managed accounts in the context of forwarding fund materials.[161] In discussing managed accounts in the proxy context, however, the 2013 SEC Order compared a broker's effort to maintain this account "type" (*i.e.*, managed account) to the effort necessary to maintain the beneficial owner's delivery preference (*e.g.*, e-delivery and "householding").[162] This analogy is inapt. Tracking an account "type" is operationally different from tracking a delivery preference.[163]

In 2007, a senior FINRA executive publicly agreed with our view that broker-dealers should not charge suppression fees for managed accounts, clearly stating that "broker-dealers should not be forwarding the names of [separately managed account] investors to the issuers or their service providers."[164] At least one major broker-dealer also appears to agree and does not include Managed Account records when it sends its data files to the predominant vendor for shareholder report delivery.[165]

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[161] The SEC's order approving the 2013 NYSE fee schedule amendments discussed managed accounts in the context of delivering operating company proxies. NYSE sets the maximum preference management fees for managed accounts at a rate that is half that of preference management fees for other types of accounts. Halving the fee was supposed to allow for issuers and brokers to share the cost of "the admittedly real processing work that is done to track and maintain the voting and distribution elections made by the beneficial owners of the stock positions in the managed account." SEC October 2013 Order, *supra*. The SEC noted NYSE's assertion that "tracking the beneficial owner's voting and distribution election is as necessary with Managed Accounts as it is with any other proxy distribution election eliminating the need for paper mailing, such as consent to e-delivery." *Id.*

Beneficial owners do not change their voting and distribution election, however, as a practical matter. Rather, we understand that voting and distribution delegation is typically hard-wired into investment management agreements, especially for the retail products that account for the majority of managed accounts.

[162] *See* SEC May 2013 Order, *supra*, at p. 51-52.

[163] Account "type" is determined at account opening based on customer direction regarding registration of the account and the level of advisory services (*i.e.*, how much discretion the broker is allowed regarding investment decisions) to be provided by the broker-dealer. Account "type" generally remains unchanged. The broker's recordkeeping system typically uses the account "type" designation to drive a number of functions and services provided to the customer, including tax reporting and statement delivery. A shareholder's delivery preference is tracked by simply recording a "yes/no" indicator on the account. Shareholder delivery preference may evolve over time and is used to track, among other things, "householding" and summary prospectus delivery elections.

[164] *See* STA/SSA 2012 Letter, *supra*, at p. 3.

[165] *See id*., at p. 13 (where he was addressing a SIFMA symposium on proxies).

Anecdotally, some of ICI's members have spoken to their distribution partners about inappropriately including Managed Accounts in the data files that the intermediaries transmit to the vendor. Some of these intermediaries then have attempted to remove Managed Accounts from the data file they send to the vendor. We understand that, in at least one case, the vendor informed an intermediary that the intermediary is contractually required to include Managed Accounts in the data that it sends to the vendor.