IDC
INDEPENDENT DIRECTORS COUNCIL

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January 9, 2017

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Universal Proxy; File No. S7 24-16

Dear Mr. Fields:

The Independent Directors Council[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposed amendments to the federal proxy rules.[2] The Commission proposes to require the use of universal proxies in connection with contested elections of directors other than those involving registered investment companies and business development companies. We commend the Commission for proposing to exclude funds from the proposed mandate and for recognizing that rules designed for operating companies are not always appropriate for funds. Mandating universal proxies in the fund context would be unnecessarily costly to funds and disruptive to effective board governance practices—with limited, if any, benefits for fund shareholders.

The proposal would require, in contested elections of directors, the use of universal proxies that include the names of both registrant and dissident nominees, allowing shareholders to vote for a mix of registrant and dissident nominees (*i.e.*, to "split their vote"). Currently, shareholders voting by proxy are effectively required to submit votes on either the registrant's or the dissident's proxy card and

[1] IDC serves the US-registered fund independent director community by advancing the education, communication, and policy positions of fund independent directors, and promoting public understanding of their role. IDC's activities are led by a Governing Council of independent directors of Investment Company Institute member funds. ICI is a leading global association of regulated funds, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the US, and similar funds offered to investors in jurisdictions worldwide. ICI's members manage total assets of US$18.4 trillion in the US, serving more than 95 million US shareholders, and US$1.6 trillion in assets in other jurisdictions. There are approximately 1,800 independent directors of ICI-member funds. The views expressed by IDC in this letter do not purport to reflect the views of all fund independent directors.

[2] *Universal Proxy*, SEC Rel. Nos. 34-79164, IC-32339 (Oct. 26, 2016), *available at* https://www.sec.gov/rules/proposed/2016/34-79164.pdf.

cannot pick and choose from nominees on both cards. In order to split a vote, a shareholder generally must attend the shareholder meeting in person.

IDC strongly supports the Commission's determination that funds should be excluded from the universal proxy mandate. As the Commission notes and as we discuss more fully below, split-ticket voting could disrupt the unique governance models employed by funds, to the detriment of efficient and effective fund governance. Moreover, fund shareholders have little reason to seek split-ticket voting, and with significant shareholder rights already in place under the Investment Company Act of 1940 ("1940 Act"), a universal proxy mandate would have limited benefit for fund shareholders.

In contrast to public operating company boards, fund boards typically oversee multiple funds within a fund complex. In most cases, funds are governed according to one of two models—a "unitary" board (consisting of one group of directors who serve on the board of every fund in the complex) or "cluster" boards (consisting of two or more separate boards of directors within the complex, that each oversees a different group of funds).[3] These structures enable boards to efficiently oversee common matters, such as compliance and valuation, across multiple funds in a complex. Funds within a complex generally are served by common personnel, use the same service providers, and follow the same policies and procedures. It is typically far more efficient to have a single board, or a few cluster boards, review these common policies and procedures and oversee common arrangements. It is also much easier to implement any changes on a complex-wide basis than in a piecemeal fashion (which could occur if different boards for different funds were to reach different conclusions). Indeed, the unitary and cluster board structures enhance fund governance, to the benefit of fund shareholders.[4]

The Commission rightly looks to fund boards to determine for themselves how they should structure their own governance models.[5] Commission rules require fund boards to conduct annual self-assessments, which include evaluations of the number of funds on whose boards each director serves.[6] Those rules also require independent directors to select and nominate other independent directors for

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[3] A recent ICI/IDC survey of fund complexes showed that 86 percent of the complexes had a unitary board structure and 14 percent had a cluster board structure. *See* Overview of Fund Governance Practices, 1994-2015, available at https://www.idc.org/pdf/pub_15_fund_governance.pdf, at 5.

[4] For more information, see IDC, *Director Oversight of Multiple Funds* (2005), available at https://www.idc.org/pdf/ppr_idc_multiple_funds.pdf.

[5] *See e.g.,* Investment Company Governance Rule, 69 Fed. Reg. 3,472, 3,476 (Jan. 23, 2004) (recognizing that "[i]t would be difficult to determine the optimum number of funds that a particular director or group of directors can serve").

[6] The Commission's fund governance standards—to which virtually all funds adhere—require that the independent directors evaluate "at least once annually the performance of the board of directors and the committees of the board of directors, which evaluation must include a consideration of the effectiveness of the committee structure of the fund board and the number of funds on whose boards each director serves." Rule 0-1(a)(7)(v) under the 1940 Act.

the fund board—a process that independent directors undertake with great care.[7] When considering the addition of a new independent director, boards generally consider prospective candidates' experience, qualifications, attributes, and skills and how they fit within the overall skillset of the existing fund board. They look for candidates who will represent shareholders' interests with diligence and work with fellow directors in a collegial manner.[8]

The proposal, if applied to funds, could disrupt the governance model and the composition of the board, which the board adopted and developed. If a dissident nominee were elected to one fund in a fund complex, the complex would lose the unitary or cluster board governance structure, because one board would oversee all of the funds in the complex except the one with the new director (and, in a cluster board context, one board would oversee all of the funds in the cluster except the one with the new director).

The change in governance structure would cause the fund to incur additional costs and experience administrative difficulties. For example, arrangements would have to be made for the one director to leave during discussions that pertain only to other funds that the director does not oversee (particularly when the discussions are of a highly confidential nature), and board materials would have to be customized for that director. Moreover, efficient processes for board reporting (such as providing aggregate data for all funds) and for applying one set of procedures for all funds would be disrupted if the data had to be disaggregated to some extent and procedures tailored for a particular fund. Setting up procedures to deal with these issues would generate additional costs that ultimately would be borne by fund shareholders.

Over time, this situation could be exacerbated, with many different boards overseeing many different funds in the complex. And the benefits of the unitary and cluster board models discussed above would be diminished, if not eliminated, to the detriment of efficient and effective fund governance on behalf of fund shareholders.

While the costs of applying a universal proxy mandate to funds could be high, the benefits to shareholders would be limited. Simply stated, universal proxies are not necessary in the fund context. Open-end funds are generally not required to hold annual shareholder meetings, and contested elections are rare. Closed-end fund shares, on the other hand, are listed on exchanges and typically required by the exchange's rules to hold annual shareholder meetings. Contested elections may arise for closed-end funds because shares may trade at a discount to the fund's net asset value, giving dissidents an incentive to pursue actions to reduce or eliminate the difference. To address the discount, however,

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[7] The Commission's fund governance standards require that the independent directors "select and nominate any other" independent director of the fund. Rule 0-1(a)(7)(ii) under the 1940 Act.

[8] *See generally*, IDC, *Considerations for Board Composition: From Recruitment through Retirement* (October 2013), available at https://www.idc.org/pdf/pub_13_considerations_board_comp.pdf.

dissidents generally do not seek split-ticket voting, but rather, seek to gain control of the entire board of directors, or seek more targeted changes, such as terminating the fund's advisory contract.

The specific rights granted to fund shareholders by the 1940 Act is another reason why split-ticket voting is not necessary for fund shareholders. Under the 1940 Act, fund shareholders must approve advisory contracts and material amendments to the contracts, ratify or reject the selection of the independent public accountant, and approve changes to fundamental investment policies. Fund shareholders therefore have the ability to vote on important governance matters that would otherwise be addressed by directors and that operating company shareholders do not have. These expansive voting rights limit the value to fund shareholders of a universal proxy mandate.

For the reasons discussed above, IDC strongly supports the Commission's determination that funds should be excluded from the universal proxy mandate.

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If you have any questions about our comments, please contact me at [redacted].

Sincerely,

Amy Lancellotta

Amy B.R. Lancellotta
Managing Director
Independent Directors Council

cc: The Honorable Mary Jo White, Chair
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Mr. Keith F. Higgins
Director, Division of Corporation Finance