



SR-NYSE-2006-92
9

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

RECEIVED
ES 118854
2006 DEC 19 AM 11:51

Paul Schott Stevens, PRESIDENT

202/326-5901 FAX: 202/326-5806
paul.stevens@ici.org

CHAIRMAN'S
CORRESPONDENCE UNIT

December 18, 2006

The Honorable Christopher Cox
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Costs of Eliminating Discretionary Broker Voting on Uncontested
Elections of Investment Company Directors

Dear Chairman Cox:

Chris

Upon becoming President of the Investment Company Institute¹ in June 2004, I pledged that we would do our part, in the comment process, to assist the Securities and Exchange Commission to conduct more meaningful and informative cost-benefit analysis of rule proposals. I know that you agree on the vital importance of weighing the impact of regulation on efficiency, competition, and capital formation, as Congress has directed.

To further this important goal, the Institute surveyed its members and prepared the attached report on the impact on investment companies of the New York Stock Exchange's proposal to eliminate discretionary broker voting for uncontested elections of directors.² As discussed in more detail below, our report concludes that the proposal will have a disproportionate impact on funds as compared to operating companies, will create significant difficulties for funds in achieving quorums and electing fund directors, and will cause funds to incur significant and unnecessary costs - costs which

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

² See NYSE File No. SR-2006-92. The NYSE proposal would implement recommendations of the NYSE's Proxy Working Group. See *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006) ("Report"). The Institute repeatedly has expressed its concerns regarding the impact of the proposal on investment companies, including its potential costs, to the NYSE Working Group in conjunction with the issuance of the Report. See Letter from Elizabeth R. Krentzman, General Counsel, Investment Company Institute to Catherine R. Kinney, President and Chief Operating Officer, NYSE Group, Inc., dated July 18, 2006 ("July 2006 Letter") (copy attached). See also Letter from Frances M. Stadler, Deputy Senior Counsel, Investment Company Institute, to Mr. Larry Sonsini, Chairman, NYSE Proxy Working Group, dated June 3, 2005.

ultimately will be borne by fund shareholders. Accordingly, the Institute urges that investment companies be excluded from the NYSE proposal.³

Significant Findings of Institute Report

The Proposal Will Have a Disproportionate Impact on Funds

Investment companies have a far higher proportion of retail shareholders than most operating companies. Because retail shareholders are less likely than institutional investors to vote their proxies (many institutional investors have a fiduciary responsibility to do so), the NYSE proposal will have a disproportionate impact on funds, and funds will incur greater costs from the elimination of discretionary broker voting. Our research indicates that while retail shareholders hold about forty-eight percent of the value of operating company shares, they hold about sixty-four percent of the value of mutual fund shares. This disparity is even greater for closed-end funds, where retail investors own about ninety-eight percent of the value of shares.

Funds Will Have Significant Difficulties Achieving A Quorum Under the NYSE Proposal

NYSE members hold a substantial portion of fund shares in street name. Our research indicates that half of funds sold through sales forces had at least eighty percent of the fund's total shares outstanding held in this manner. Our report found that beneficial shareholders tend to return their proxies at a fairly low rate – approximately thirty two percent of fund shares held in street name were voted. In contrast, when brokers are permitted to vote uninstructed shares, almost all shares (ninety-three percent) held in street name were voted. A majority of outstanding shares often must be voted for an investment company to achieve a quorum with respect to matters pertaining to the election of directors. By eliminating broker voting for fund shares held in street name, the NYSE proposal will create significant difficulties for funds in achieving a quorum, and, in turn, electing fund directors. An uncontested director election by its nature is highly unlikely to elicit strong interest or participation from rank and file fund shareholders, only fifteen percent of whom ascribe significance to information about a mutual fund's directors, when selecting a fund, according to a 2006 Institute survey.⁴

³ The Committee on Capital Markets Regulation, in its interim report on ways to improve the efficiency of the U.S. capital markets, recognized the difficulties created by the NYSE proposal for investment companies. While the Committee supported the application of the NYSE proposal to corporate issuers, the Committee stated that it believes that the application of the proposal to voting by mutual fund shareholders "should be reconsidered in light of the practicalities of such situations." See Interim Report of the Committee on Capital Markets Regulation, November 30, 2006 (as revised on December 5, 2006) at p.128.

⁴ See *Understanding Investor Preferences for Information*, Investment Company Institute (2006).

Fund Proxy Costs Will More than Double Under the NYSE Proposal

Because a significant number of fund shareholders choose not to vote shares held in street name, funds are forced to incur increased costs taking steps necessary to encourage shareholders to vote their proxies. Our research shows that these costs are significant.⁵ Because funds will have to engage in multiple solicitations, typical proxy solicitation costs will more than double from \$1.65 to \$3.68 for each shareholder account. Fund expense ratios will rise between one to two basis points, on average, with some funds' expense ratios increasing more than five basis points.⁶ Because the elections that are the subject of the NYSE proposal are uncontested, the same directors, in most instances, will be elected whether or not funds bear these increased costs.

* * * * *

We look forward to working with the Commission on this very important proposal. In the meantime, if you have any questions regarding our comments or would like additional information, please contact me at (202) 326-5901, Elizabeth R. Krentzman at (202) 326-5815, Ari Burstein at (202) 371-5408, or Dorothy M. Donohue at (202) 218-3563.

Sincerely,



Paul Schott Stevens
President

cc: The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Annette L. Nazareth
The Honorable Kathleen L. Casey

⁵ To obtain approval of matters on which brokers are not permitted to vote ("non-routine matters"), it is frequently necessary for funds to engage soliciting firms and conduct multiple mailings, the cost of which can be significant. Even with these measures, funds often must adjourn meetings due to an insufficient voting response. Our research indicates that no shareholder meeting in our entire sample with only routine matters on the agenda required a re-solicitation of shareholders or was adjourned for lack of a quorum. This result was due to the high rate at which brokers vote. In contrast, more than half of shareholder meetings in our sample with at least one non-routine matter required at least one re-solicitation.

⁶ These expected increases in expense ratios from eliminating broker voting are about on par with the cost of custody fees.

The Honorable Christopher Cox

December 18, 2006

Page 4 of 4

Andrew J. Donohue, Director, Division of Investment Management
Erik R. Sirri, Director, Division of Market Regulation
John W. White, Director, Division of Corporation Finance

U.S. Securities and Exchange Commission

Attachments

* * * * *

About the Investment Company Institute

ICI members include 8,792 open-end investment companies (mutual funds), 662 closed-end investment companies, 269 exchange-traded funds, and 4 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$9.898 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 93.9 million shareholders in more than 53.8 million households.



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

July 18, 2006

Catherine R. Kinney
President and Co-Chief Operating Officer
NYSE Group, Inc.
11 Wall Street
New York, NY 10005

Re: Report and Recommendations of the Proxy Working Group to the
New York Stock Exchange

Dear Ms. Kinney:

The Investment Company Institute¹ welcomes the opportunity to provide its views on the New York Stock Exchange's Proxy Working Group Report.² The Report reflects the work of many participants in the corporate community over the course of more than a year. It analyzes the proxy process and concludes that it is an integrated process in need of several improvements. In particular, it recommends that the election of directors be classified as a "non-routine" matter on which brokers would not be permitted to vote unless instructed how to do so by their customers who beneficially own the stock. The Report also identifies several other aspects of the proxy process that deserve evaluation and possible change and recommends that they be studied in the future.

The Institute agrees with the Working Group's observation that shareholder voting for directors is an important component of good corporate governance. The Institute believes, however, that the Working Group's recommendation puts all issuers, including investment companies, "between a rock and a hard place" because shareholders typically do not understand the proxy process, typically choose not to vote, and in most cases, cannot be contacted by the issuers who would urge them to vote. As a result, if brokers are not permitted to vote on uncontested elections of directors, funds and other issuers will have significant difficulties in achieving quorums and getting directors elected.

¹ The Institute is the national association of the U.S. investment company industry. More information about the Institute is attached to this letter.

² See *Report and Recommendations of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006) ("Report"). The Institute previously provided its views on proxy voting issues to the Working Group. See Letter from Frances M. Stadler, Deputy Senior Counsel, Investment Company Institute, to Mr. Larry Sonsini, Chairman, NYSE Proxy Working Group, Wilson, Sonsini, Goodrich & Rosati, dated June 3, 2005 ("2005 Institute Letter").

These concerns are not theoretical. Our members report significant difficulties in achieving quorums and getting matters approved when brokers are not permitted to vote. To get matters approved, it is frequently necessary for funds to engage soliciting firms and conduct multiple mailings. The costs of these measures can be significant. Even with these measures, funds often must adjourn meetings due to an inadequate voting response. Changing approval of directors from a "routine" to a "non-routine" matter will greatly exacerbate this problem. According to a proxy service firm, if brokers are not permitted to vote uninstructed shares, the cost of proxy votes could increase by thirty to forty percent for funds.

Because of these concerns, we recommend that the NYSE continue to allow brokers to vote uninstructed shares on uncontested director elections until certain steps are taken. Educating shareholders about the proxy process and the importance of voting so as to improve shareholder responsiveness to proxies is the appropriate first response to this issue, given the significance of shareholder voting for directors. In addition, Securities and Exchange Commission rules should be revised to permit issuers to contact their shareholders (or their nominees in certain cases). Only after these efforts are undertaken and all constituents, including the NYSE, are satisfied that shareholders will exercise their voting rights should director elections become "non-routine." The Institute stands ready to assist the NYSE in any way it can to achieve these goals.

We recognize that changing the dynamics of the proxy process in a way that results in individual beneficial shareholders choosing to exercise their voting rights may be a difficult task that will take some time. If the NYSE chooses not to wait for this change in shareholder behavior before prohibiting brokers from voting on directors, we urge the NYSE to permit brokers to exercise proportional voting with respect to shares for which voting instructions are not received.

In addition, we urge the NYSE to make further changes to its corporate governance requirements, including exempting closed-end funds from the NYSE's annual meeting requirement. Because closed-end funds are already subject to voting requirements under the Investment Company Act of 1940, which are intended to ensure shareholder participation in key decisions affecting the fund, the NYSE's requirement is unnecessary.

* * *

Background

Funds have an interest in proxy voting from the perspective of both investors and issuers. As investors, funds vote proxies at annual and special meetings of shareholders. As issuers, funds hold meetings of shareholders when required by state law and/or the Investment Company Act of 1940 and as needed to conduct corporate business. Closed-end funds listed on the NYSE and other exchanges are required to hold annual shareholder meetings irrespective of the specific matter being presented for a vote. The vast majority of open-end and closed-end fund shares are sold through NYSE member firms, which are subject to NYSE Rule 452. As a result, they will not be permitted to vote uninstructed

Ms. Catherine R. Kinney

July 18, 2006

Page 3

shares on the election of fund directors if the Working Group's recommendation is implemented. Therefore, the Institute has a keen interest in the Report's recommendations. Our comments below focus on issues affecting funds as issuers of voting securities.³

Prohibiting Brokers from Voting on Directors

Implementing the Working Group's recommendation to make the election of directors a "non-routine" matter at this time raises significant practical problems as previously discussed. We recommend that the NYSE continue to allow brokers to vote uninstructed shares on uncontested director elections until: (i) shareholders are sufficiently educated about the proxy process and the importance of voting so that they exercise their right to vote; and (ii) the SEC revises its rules to permit issuers to contact their shareholders.

Shareholder Education. As the Report points out, there appears to be "widespread ignorance" of the proxy process. Significantly, research conducted at the request of the Working Group shows that few investors realize the significant burdens and costs that are often incurred if they do not send in their proxy votes. We therefore recommend that the NYSE conduct an aggressive education campaign to address the central issue of shareholder apathy and encourage more investors to choose to exercise their voting rights. An education campaign should be a collaborative effort among regulators, broker-dealers, issuers, and other participants in the proxy process and could include leveraging the Internet to provide shareholders with immediate and interactive information about the proxy process.

Communication Between Issuers and Shareholders. A majority of shares, including investment company shares, are held in "street name," by brokers, banks, or their depositories. Seventy-five percent of shares held in street name are owned by shareholders who have indicated that issuers may not contact them.⁴ We understand that this percentage may rise because broker-dealers increasingly are setting up accounts as OBOs if their clients do not indicate a preference either way. This feature of the proxy process presents a significant obstacle for issuers trying to obtain a quorum and get matters approved when only beneficial owners, not brokers, are permitted to vote.

³ As investors, funds consider the voting of proxies of companies in which they invest to be part of the investment process. Accordingly, the vast majority of proxies that funds receive are voted. Therefore, whether the election of directors is deemed a routine or a non-routine matter will have little, if any, effect on the voting practices of funds as investors. See Letter from Craig S. Tyle, General Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated December 6, 2002 (Institute letter regarding proxy voting by investment companies and investment advisers). To the extent that the companies in which funds invest are subject to higher costs in connection with solicitation of proxies, funds will share that burden along with other investors in the company.

⁴ Shareholders choose whether issuers may contact them. Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs." Shareholders who do not object to having their names and addresses given to issuers are called "Non-Objecting Beneficial Owners" or "NOBOs." SEC rules prohibit banks and brokers from providing issuers with the names of OBOs.

We therefore recommend that SEC rules be amended to eliminate the NOBO/OBO distinction and permit investors who choose to remain anonymous to appoint a nominee who could be contacted by issuers.⁵ Permitting issuers to communicate with their shareholders (or their nominees) will enable them to "get out the vote," enhancing their ability to obtain needed quorums and successfully resolicit shareholders, if necessary.

Proportional Voting

One alternative considered, but rejected, by the Working Group was to adopt a proportional voting system as an alternative to existing Rule 452. Under this approach, uninstructed shares would be voted in the same proportion as instructed shares.

Proportional voting has important practical advantages.⁶ It permits issuers to achieve quorums and directors to be elected. Beneficial owners who choose to vote -- not brokers -- determine the outcome of a director election. In addition, permitting proportional voting is consistent with the NYSE's treatment of voting with respect to auction rate preferred stock⁷ and provisions governing fund voting under the Investment Company Act.⁸

Therefore, if the NYSE limits broker voting as the Working Group recommends without first improving shareholder responsiveness to proxies, the Institute urges the NYSE to permit brokers to

⁵ It is important to permit investors to keep their identities confidential if they so choose. For example, an institutional investor in the process of increasing its stake in a particular issuer may not want to disclose its current trading activity or ownership position to company management or others. Preserving the confidentiality of trading information is an issue of great concern to the Institute and its members. *See, e.g.*, Letter from Paul Schott Stevens, President, Investment Company Institute, to the Honorable Christopher Cox, Chairman, U.S. Securities and Exchange Commission, dated September 14, 2005. The Business Roundtable has recommended this approach to the SEC. *See, e.g.*, Letter from Steve Odland, Chairman, Corporate Governance Task Force, Business Roundtable, to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, dated April 12, 2004.

⁶ The Institute previously recommended that the NYSE allow proportional voting if the Working Group recommended substantial changes to proxy voting by brokers. *See* 2005 Institute Letter. The Working Group stated that one difficulty with proportional voting was determining how to tabulate votes, noting that proportional voting could be tied to voting that occurs at the individual broker level or to the aggregate voting of all record holders. We believe that these considerations are outweighed by the practical benefits that any method of proportional voting will achieve. While we would support the adoption of proportional voting at either the individual broker level or as an aggregation of the voting of all record holders, we recognize that it would be easier, as a practical matter, to permit proportional voting at the individual broker level. To address concerns regarding the potential for manipulating votes at the broker level, the NYSE could require brokers to adopt and implement written policies and procedures for voting and to maintain related voting records. *See, e.g.*, Rule 206(4)-6 under the Investment Advisers Act of 1940 (requiring investment advisers to adopt written policies and procedures that are reasonably designed to ensure voting of client securities in the best interests of clients).

⁷ *See* Rule 452.12.

⁸ Proportional voting is required under Section 12(d)(1)(E) of the Investment Company Act and is also used in other situations. Section 12(d)(1)(E) concerns an investment company whose only assets are shares of another registered open-end or closed-end investment company.

implement proportional voting.⁹ To avoid allowing a matter to be approved by just a few shareholders, we recommend that the NYSE permit proportional voting only in instances where a minimum number of beneficial owners vote or, alternatively, a minimum percentage of shares outstanding are voted.¹⁰

Exclusion of Money Market Funds

Regardless of the approach the NYSE decides to take regarding the voting of uninstructed shares, we recommend that NYSE member firms be permitted to vote uninstructed proxies in uncontested elections of directors of money market funds. Beneficial owners of money market funds consider these investments to be an alternative to bank accounts rather than investments in corporate issuers. As a result, even with education of shareholders and enhanced communication between shareholders and issuers, we believe that few, if any, money market fund shareholders will choose to vote.

Elimination of Annual Meeting Requirement for Closed-End Funds

NYSE Listed Company Manual Rule 302.00 requires closed-end funds to hold annual shareholder meetings. For many years, the Institute and its closed-end fund members have believed that this requirement is unnecessary because closed-end funds are already subject to voting requirements under the Investment Company Act, which are designed to ensure that shareholders participate in what are considered to be the most significant decisions concerning the fund.¹¹ In addition, we believe that in view of the fact that federal and, in many instances, state regulators¹² have concluded that it is not necessary for closed-end funds to have annual shareholder meetings, the NYSE should exempt closed-end funds from its annual shareholder meeting requirement. There are significant costs associated with holding annual meetings due to difficulties in obtaining a quorum, which then forces adjournments and resolicitations. These costs will be increased if the Working Group's recommendation is implemented.

⁹ Alternatively, we would not object to the NYSE permitting brokers the limited authority to vote uninstructed proxies at shareholder meetings solely for quorum purposes. This approach balances the need of companies to attain quorums so that they can conduct their business while limiting the ability of brokers to determine the outcome of non-routine matters.

¹⁰ Whatever minimum is chosen will have to take into account the ability of issuers to contact shareholders to get out the vote, including the percentage of shares held in OBO accounts.

¹¹ For example, Section 13 requires a shareholder vote before an investment company may change certain investment and other policies, Section 15 requires shareholder approval of the investment management agreement between the fund and its investment adviser, Section 16 requires that an investment company's initial board of directors be elected by shareholders, and Section 32 requires that a fund's independent public accountant be approved by the shareholders under certain circumstances.

¹² Many closed-end funds are domiciled in jurisdictions that do not require annual meetings. For example, many closed-end funds are Massachusetts business trusts, which are not required to hold annual shareholder meetings. In addition, a number of closed-end funds are incorporated in Maryland, which requires a fund to hold a shareholder meeting only when required by the Investment Company Act.

Therefore, we recommend that the NYSE exempt closed-end funds from its annual meeting requirement. At the very least, we urge the NYSE to scale back the shareholder meeting requirement for closed-end funds to once every three years.

Other Issues

A great deal of concern was expressed to the Working Group about the increasing role and influence of shareholder advisory services in the proxy system. We agree with the Working Group's recommendation that a study of these services should be undertaken. Shareholder advisory services and proxy voting groups are situated similarly to brokers in that they often make voting decisions with respect to shares in which they do not have an economic interest. However, these entities are not subject to the disclosure or other obligations imposed on brokers by the federal securities laws and are not subject to NYSE, SEC, or any other regulatory oversight. Thus, the combination of the absence of regulation and oversight, and the exercise of voting power may have negative ramifications for the proxy process that warrant study.

The Working Group also recommends that the NYSE engage an independent third party to analyze and make recommendations regarding the structure and amount of fees paid under NYSE Rule 465. It recommends that the third party analysis include a study of ADP's performance and business process by which it distributes proxies.¹³ Following the study, it recommends that the NYSE consider revising the existing fee schedule and related issues as appropriate. The Institute agrees that an analysis is warranted, especially given that virtually all banks and brokers contract out the administrative process for proxy mailings to one vendor.

* * *

The Institute appreciates the opportunity to provide its views on the Report. The Report discusses the many facets of the proxy process and identifies significant issues that are worthy of further study. We urge the NYSE to address the practical difficulties that will be created by the Working Group's recommendation before eliminating the right of brokers to vote uninstructed shares on the election of directors.

¹³ We understand that with respect to contested proxy solicitations, ADP has a set of informal procedural rules for soliciting and counting proxies. As part of its overall assessment of the proxy process, we recommend that the NYSE study and make recommendations regarding these procedures with the goal of helping to ensure fairness to all participants in contested proxy solicitations.

About the Investment Company Institute

ICI members include 8,712 open-end investment companies (mutual funds), 653 closed-end investment companies, 177 exchange-traded funds, and 5 sponsors of unit investment trusts. Mutual fund members of the ICI have total assets of approximately \$9.212 trillion (representing 98 percent of all assets of US mutual funds); these funds serve approximately 89.5 million shareholders in more than 52.6 million households

**Costs of Eliminating Discretionary Broker Voting on
Uncontested Elections of Investment Company Directors**

December 18, 2006



**Costs of Eliminating Discretionary Broker Voting on
Uncontested Elections of Investment Company Directors**

December 18, 2006



1401 H. Street, NW Suite 1200
Washington, DC 20005-2148
202/326-5800

www.ici.org

Copyright © 2006 by the Investment Company Institute. All rights reserved.

Table of Contents

Executive Summary	1
Background.....	1
Survey Design.....	1
Key Findings.....	2
Factors Affecting Total Proxy Costs From Eliminating Discretionary Broker Voting	3
Large Retail Ownership Creates a Disproportionate Impact on Funds	3
NYSE Members' Holdings of Fund Shares Are Substantial	4
Beneficial Owners of Fund Shares Held in Street Name Return Proxies At a Fairly Low Rate.....	6
Funds Cannot Communicate Directly With Some Shareholders.....	9
Re-Solicitations and Adjournments of Fund Shareholders Will Increase.....	11
Impact on Fund Industry from Eliminating Discretionary Broker Voting.....	15
Proxy Costs For Funds Will Rise Substantially.....	15
Many Shareholders Will Pay More In Fund Expense Ratios	18
Small Fund Advisers Will Bear a Significant Burden.....	22
Appendix: Investment Company Institute Survey on Shareholder Voting	23

Executive Summary

BACKGROUND

Under New York Stock Exchange (“NYSE”) Rule 452, NYSE members—which consist primarily of brokers and banks—are allowed to vote uninstructed proxies for their customers who beneficially own the stock on routine items at shareholder meetings. This practice is commonly referred to as discretionary broker voting. Currently, an uncontested election of directors is considered a routine item, and NYSE members are allowed to vote proxies for beneficial owners who have not returned their proxies within 10 days of the date of the shareholder meeting.

In June 2006, the NYSE’s Proxy Working Group recommended the elimination of discretionary broker voting by NYSE members in an uncontested election of directors.¹ The NYSE subsequently filed a rule proposal with the Securities and Exchange Commission (“SEC”), which, if approved by the SEC, would effectuate this change to discretionary broker voting for uncontested elections of directors. If approved, the rule proposal would apply to proxies relating to closed-end funds and mutual funds whose shares are held through NYSE member firms.

Investment companies generally hold shareholder meetings when required by state law or the Investment Company Act of 1940 and as otherwise needed to conduct corporate business. In addition, closed-end funds listed on the NYSE and other exchanges are required to hold annual shareholder meetings at which the election of directors is a matter presented for shareholder vote. Often, the election of directors is the only matter put before closed-end shareholders at annual meetings.

SURVEY DESIGN

The Investment Company Institute (“Institute”) surveyed members regarding their experiences with shareholder voting to assess the impact of the NYSE’s rule proposal.² We received information with respect to 105 shareholder meetings of both closed-end funds and mutual funds from 40 different fund complexes. Many funds were able to provide complete information on types of matters presented for shareholder vote, quorum requirements, number of re-solicitations and adjournments, and total proxy solicitation costs for their most recent shareholder meetings.

Rochelle Antoniewicz, ICI Senior Economist, prepared this report.

¹ See *Report and Recommendation of the Proxy Working Group to the New York Stock Exchange* (June 5, 2006).

² A copy of the survey is provided in the Appendix.

Automatic Data Processing, Inc. ("ADP") reviewed 881 fund shareholder special and annual meetings held in 2005 and, based on this review, provided information on the portion of fund shares held in street name, the portion of fund shares voted by brokers, and the portion of fund shares held by objecting beneficial owners—critical pieces of information necessary to assess the effect of discretionary broker voting on the ability of funds to obtain the required quorum and vote needed to elect directors.³

KEY FINDINGS

Our key findings on the effect of eliminating discretionary broker voting for uncontested elections of directors of investment companies are summarized below.

- Eliminating discretionary broker voting will have a disproportionate impact on funds as compared to operating companies because funds have a higher proportion of retail investors.
- NYSE members hold a substantial portion of fund shares in street name. Half of closed-end funds and mutual funds sold through sales forces had over 80 percent of the fund's total shares outstanding held in street name.
- If discretionary broker voting is eliminated, typical proxy costs are estimated to more than double from \$1.65 per shareholder account to \$3.68 per shareholder account because many funds will have to engage in multiple solicitations. Even with re-solicitations, more shareholder meetings will be adjourned.
- Beneficial owners tend to return their proxies at a fairly low rate, and discretionary broker voting is an important mechanism for achieving quorum in uncontested elections of directors. Typically, only about one-third of mutual fund shares held in street name are voted by beneficial owners.
- Conservative analysis indicates that fund expense ratios could rise by approximately 1 to 2 basis points owing to higher proxy costs. For funds with smaller average account balances and more than the normal difficulties in obtaining voted proxies, expense ratios could increase by as much as 5 basis points.
- Small fund advisers are likely to bear a significant burden from the elimination of discretionary broker voting because many will have to assume higher proxy costs given the competitive nature of the mutual fund industry. Additional costs on small fund advisers create disincentives for entrepreneurs to enter the industry and push fund advisers with thin profit margins out of the business.

³ Respondents to the Institute's survey were largely unable to provide this information.

Factors Affecting Total Proxy Costs From Eliminating Discretionary Broker Voting

In our assessment of the difficulties associated with eliminating discretionary broker voting, we examined several factors that will affect total proxy costs:

- Retail ownership of fund shares;
- NYSE members' holdings of fund shares;
- Voting response by beneficial owners of fund shares held in street name;
- Shares held by beneficial owners that cannot be contacted directly by funds; and
- Frequency of re-solicitations and adjournments of shareholder meetings with non-routine matters.

LARGE RETAIL OWNERSHIP CREATES A DISPROPORTIONATE IMPACT ON FUNDS

The portion of shares held by retail investors will significantly affect the cost of soliciting votes in an uncontested election of directors, as institutional investors are more likely to vote their shares than are retail shareholders.⁴ Investment advisers to closed-end funds and mutual funds, for example, have a duty of care requirement to monitor corporate actions and vote client proxies in many instances. Fiduciaries to private pension plans—typically plan sponsors—are subject to similar requirements under ERISA.

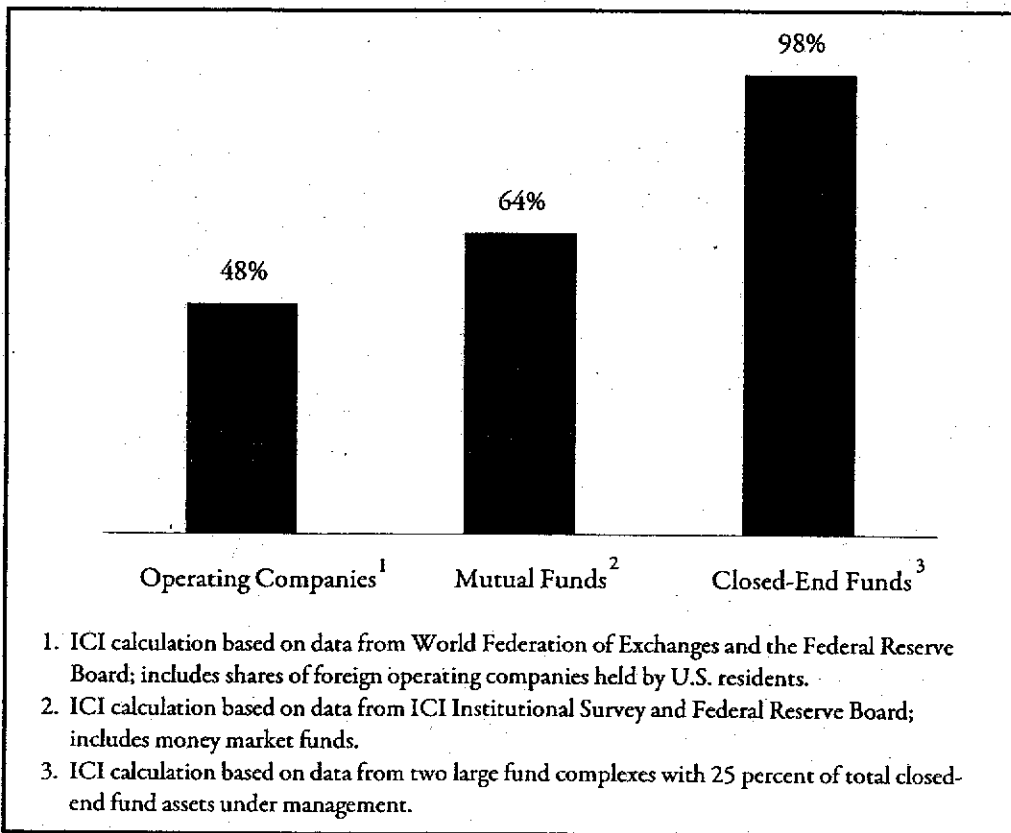
Many large and mid-sized publicly traded operating companies have a majority of their shares held by institutional investors and will be less affected by the elimination of discretionary broker voting. Based on analysis ADP provided to the NYSE's Proxy Working Group, for NYSE-listed operating companies with more than five thousand shareholders, beneficial owners voted, on average, roughly 60 percent of the companies' total shares outstanding. Many of these voted shares are likely from institutional holders. Private pension plans and registered investment companies hold almost 40 percent of publicly traded operating companies' market value. As shown in Figure 1, retail shareholders are estimated to hold a little less than half of the aggregate value of operating companies' publicly traded stock.

Many funds have a majority of their shares held by retail shareholders and will have significant difficulties in achieving a quorum and obtaining the required votes to elect directors. In the aggregate, retail shareholders are estimated to hold about two-thirds of mutual fund assets and nearly all closed-end fund assets (Figure 1). Moreover, private pension plans hold only about 20 percent of mutual fund assets, including money market assets. While these aggregate figures are useful, they tend to mask any dispersion that may be present. In examining

⁴ Institutional investors include private and government pension plans, investment advisers, insurance companies, depositories, municipalities, and proprietary accounts of brokers and dealers.

the distribution of retail holdings of mutual funds more closely, we found that for half of mutual funds, retail shareholders hold at least 82 percent of the fund's assets. The high percentage of retail shareholders helps to explain why, on average, only about one-third of beneficial owners with shares held in brokerage and bank nominee accounts voted their shares on routine matters.

Figure 1
Estimated Retail Holdings of Operating Companies and Funds
Percent of Aggregate Market Value of Shares
Year-End 2005



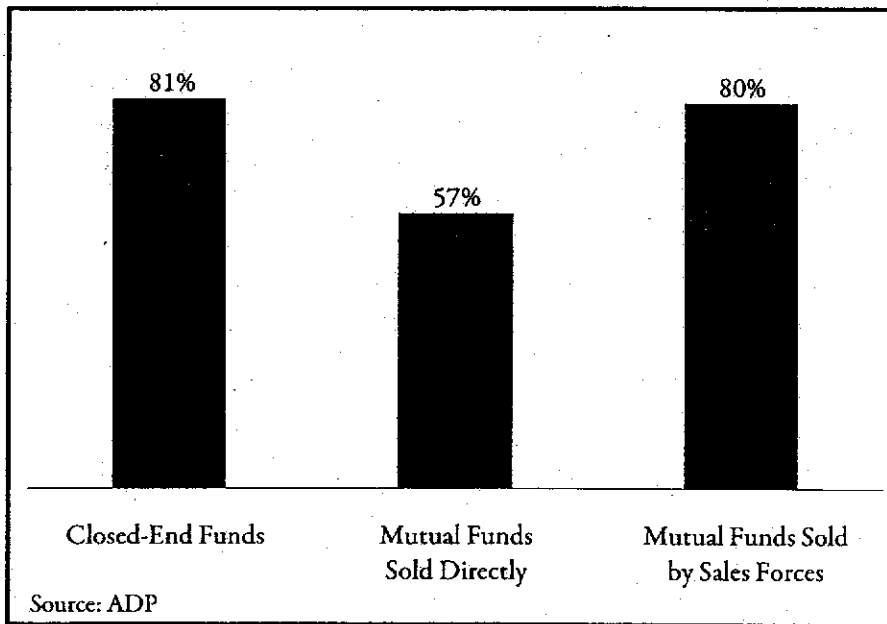
NYSE MEMBERS' HOLDINGS OF FUND SHARES ARE SUBSTANTIAL

Another factor that will affect the cost of eliminating discretionary broker voting is the portion of fund shares held by NYSE members. The vast majority of investment company shareholders buy fund shares through intermediaries, including intermediaries that are NYSE member firms. Consequently, for many funds (particularly those that distribute to retail investors through financial advisers at national wirehouses, regional broker-dealers and banks) a

substantial portion of their shares is held in “street name.”⁵ ADP estimated that street holdings of closed-end fund shares ranged from a minimum of close to 70 percent to a maximum of 100 percent. Half of closed-end funds had at least 81 percent of their total outstanding shares held in street name (Figure 2).

Mutual funds also have a significant portion of their shares held in street name. For mutual funds sold via sales forces (either proprietary or non-proprietary), shares held in street name ranged from 78 percent to 100 percent of total fund shares, with a median of 80 percent—similar to that of closed-end funds. Even mutual funds that are marketed directly to investors had a considerable amount of their shares held in street name. As shown in Figure 2, half of mutual funds sold directly had at least 57 percent of total shares outstanding held in street name. Direct-sold mutual funds often are offered on platforms or supermarkets, and these shareholder accounts generally are held in street name.

Figure 2
Percent of Fund Shares Held in Street Name
Median



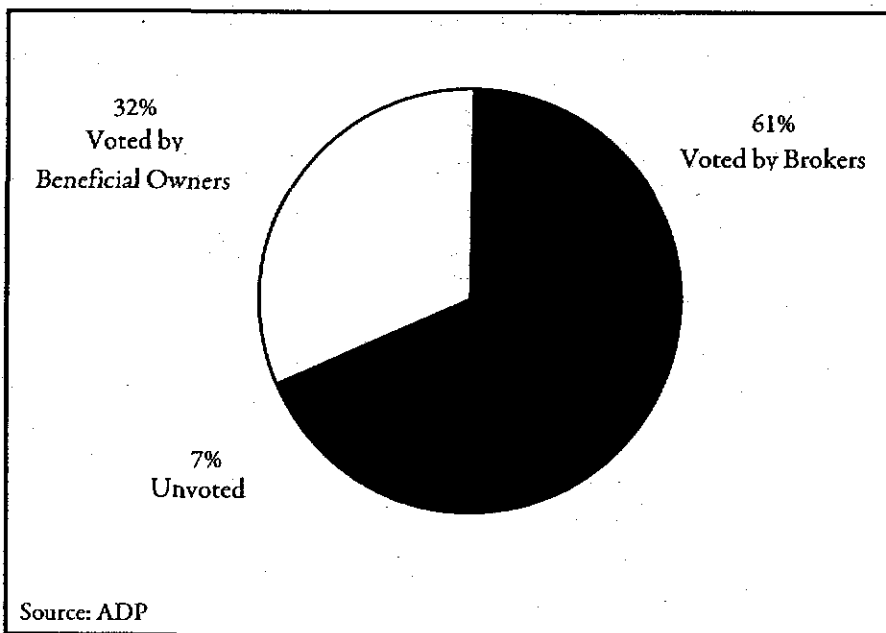
⁵ “Street name” is used to identify accounts held by banks and brokers in nominee name on behalf of the beneficial owners. Not all banks and brokers are NYSE members, and ADP was unable to separate NYSE members from non-NYSE members in their analysis. We believe, however, that the majority of banks and brokers with accounts held in street name are NYSE members and that ADP’s results provide a reasonable assessment of NYSE members’ holdings of fund shares.

**BENEFICIAL OWNERS OF FUND SHARES HELD IN STREET NAME
RETURN PROXIES AT A FAIRLY LOW RATE**

Another factor that affects the cost of eliminating discretionary broker voting is the voting response by beneficial owners. The more apt voters are to vote on the first solicitation of the proxy, the less costly it will be to eliminate discretionary broker voting. Beneficial owners of fund shares held in street name, however, return their proxies at a fairly low rate on routine items. Based on data collected by the Institute, the quorum requirement for a little over 60 percent of shareholder meetings pertaining to an election of directors was a **majority** of outstanding shares. Consequently, in an uncontested election of directors, discretionary broker voting is often important for funds to achieve a quorum.

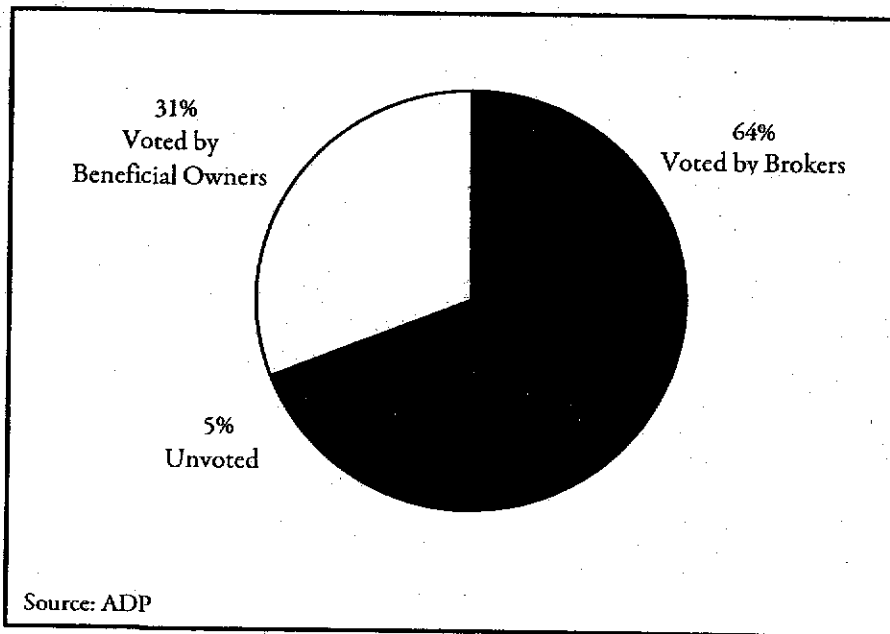
Based on ADP's analysis of voted proxies across both closed-end funds and mutual funds, beneficial owners for half of the funds voted on routine matters at most 32 percent of their shares held in street name (Figure 3). When brokers were allowed to vote, their votes accounted for at least 61 percent of shares held in street name for half of the funds. Overall, half of funds had at least 93 percent of street-held shares voted when discretionary broker voting was allowed.

Figure 3
All Funds
Percent of Fund Shares Held in Street Name
Median



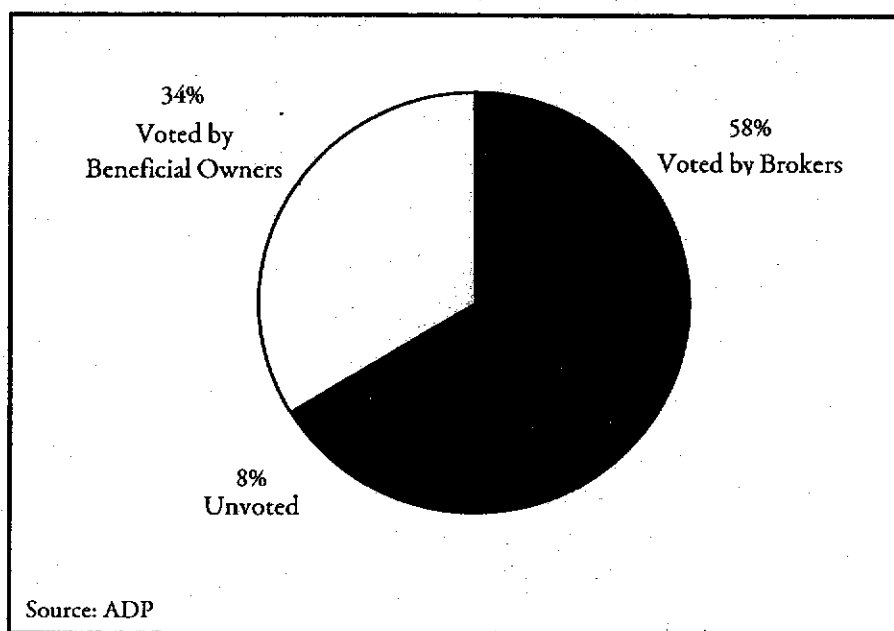
Even though closed-end fund shareholders are solicited annually by their funds to elect directors, many shareholders still do not vote. As shown in Figure 4, for half of closed-end funds, beneficial owners voted at most 31 percent of their shares held in street name. Shares voted by brokers for half of closed-end funds accounted for at least 64 percent of shares held in street name. As a result, for half of closed-end funds, at least 95 percent of shares held in street name were voted when brokers voted.

Figure 4
Closed-End Funds
Percent of Fund Shares Held in Street Name
Median



For mutual funds, most beneficial owners of shares also do not vote. For half of mutual funds, beneficial owners' votes on routine matters accounted for at most 34 percent of shares held in street name (Figure 5). Shares voted by brokers for half of mutual funds accounted for at least 58 percent of shares held in street name. For half of mutual funds, at least 92 percent of street-held shares were voted when brokers were allowed to vote.

Figure 5
Mutual Funds
Percent of Fund Shares Held in Street Name
Median



By way of example, we considered the typical situation facing a closed-end fund with a majority quorum requirement. The average closed-end fund has about 80 percent of its shares held in street name and 20 percent held directly—nearly all of the fund's shares are held by retail investors. We know from ADP that beneficial owners typically vote 31 percent of their street-held shares.⁶ As a result, a closed-end fund can expect beneficial owners with shares held in street name to vote one-quarter ($.80 \times .31$) of its outstanding total shares. Even if the closed-end fund could obtain votes from all of its remaining 20 percent of shares outstanding, the fund would only have a total of 45 percent of its outstanding shares voted—25 percent from

⁶ This typical voting response by beneficial owners is likely representative of the response to an initial solicitation for an uncontested election of directors because ratification of auditors—the only other routine matter—is rarely presented for vote to fund shareholders.

beneficial owners of shares held in street name and 20 percent from direct investors. Consequently, the typical closed-end fund would fall short of a majority quorum in an uncontested election of directors without discretionary broker voting and without undertaking additional measures to solicit votes of beneficial owners.

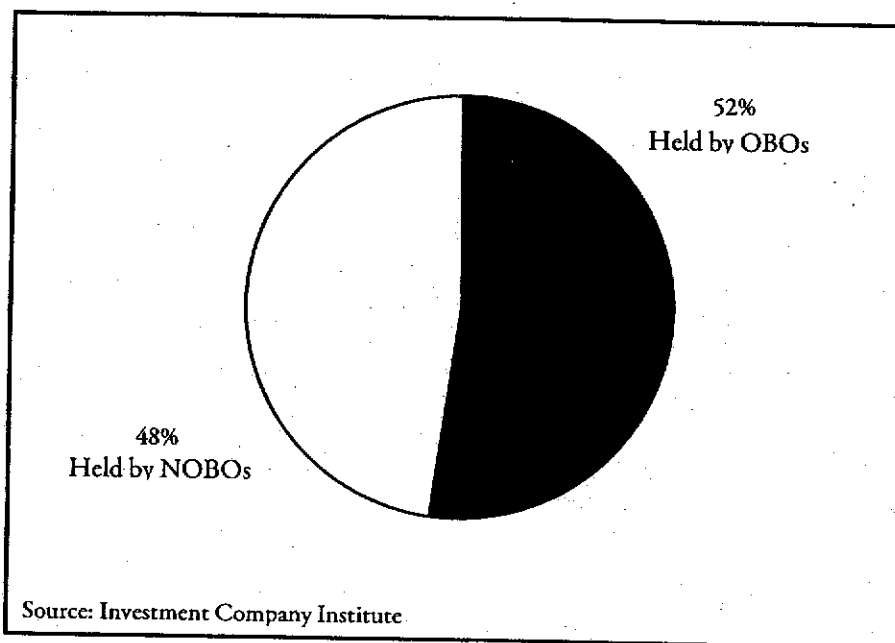
Mutual funds, which also tend to have a significant percentage of their shares held in street name and have similar voting responses by beneficial owners, will face comparable difficulties in achieving quorum if discretionary broker voting is eliminated for uncontested elections of directors. For mutual funds, these difficulties in reaching quorum will be heightened if the SEC adopts its proposal to increase the required percentage of independent directors on mutual fund boards to 75 percent. As noted in the Institute's comment letter on the proposal, mutual funds are likely to need more frequent shareholder meetings for the election of directors because the board will have less flexibility to adjust to director turnover.⁷

FUNDS CANNOT COMMUNICATE DIRECTLY WITH SOME SHAREHOLDERS

One of the challenges for funds in obtaining a quorum in the absence of discretionary broker voting is that in many cases they are prohibited from communicating directly with shareholders. Brokers invite their customers to choose whether closed-end funds, mutual funds, and other issuers whose shares they own may contact them. Based on ADP's analysis, for half of funds, at least 52 percent of shares held in street name are owned by shareholders who have indicated that issuers cannot contact them (Figure 6). Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs." SEC rules prohibit banks and brokers from providing funds with the names of OBOs. Shareholders who do not object to having their names and addresses given to issuers are called "Non-Objecting Beneficial Owners" or "NOBOs."

⁷ See Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, Securities Exchange Commission, dated August 21, 2006.

Figure 6
All Funds
Percent of Fund Shares Held in Street Name
Median



Half of funds—those with a minority of their shareholders classified as NOBOs—have a limited pool of shareholders from whom they are allowed to solicit proxy votes over the phone. When funds are uncertain of obtaining a quorum, they encourage shareholders to vote via follow-up mailings or phone solicitation. While all shareholders receive reminder mailings,⁸ at times, more intensive efforts are necessary for funds to obtain quorum. In these cases, funds often will focus their energies on NOBO shareholders. NOBOs can be contacted by either the fund or by a third-party proxy solicitor to obtain their votes over the phone.⁹

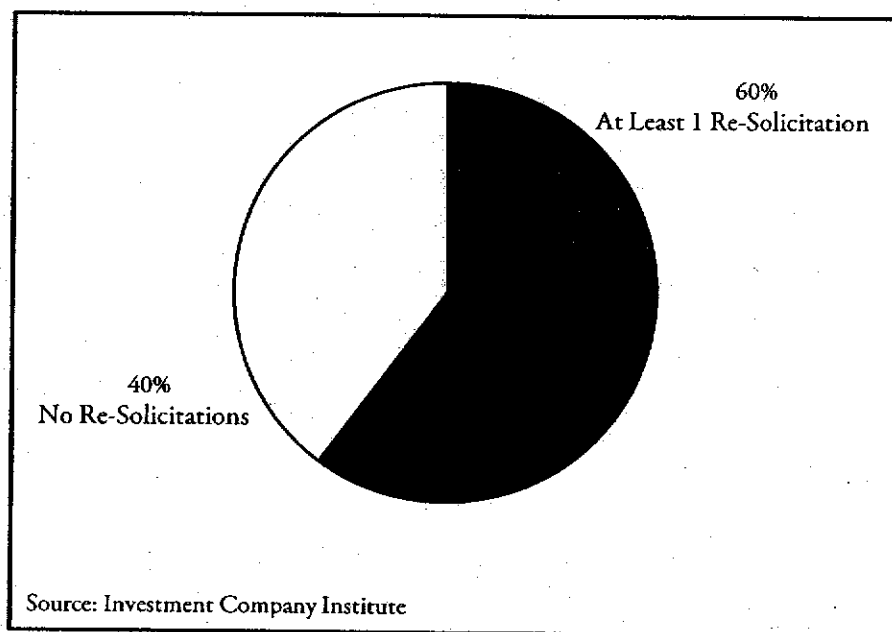
⁸ ADP sends reminder mailings to OBOs. Funds, third-party proxy solicitors, or ADP send reminder mailings to NOBOs.

⁹ Although phone solicitation is quite costly, some funds incur the expense to avoid the disruption caused by an adjournment of a shareholder meeting.

RE-SOLICITATIONS AND ADJOURNMENTS OF FUND SHAREHOLDERS WILL INCREASE

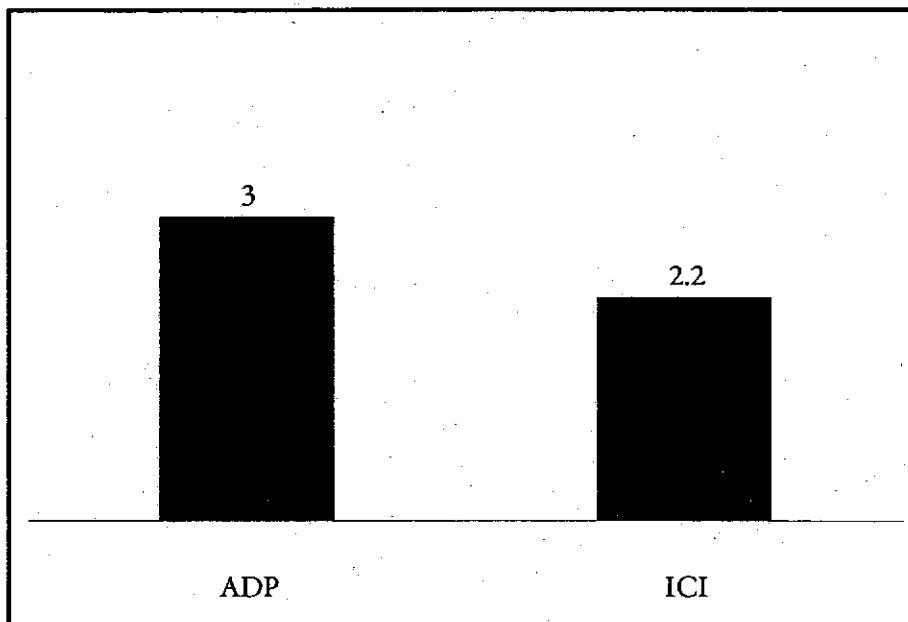
If discretionary broker voting is eliminated for uncontested elections of directors, funds can expect to re-solicit shareholders and adjourn shareholder meetings at a higher frequency. Based on the Institute's survey, not a single shareholder meeting with only routine matters, such as an uncontested election of directors and/or ratification of auditors, on the slate required a re-solicitation of shareholders or was adjourned for lack of quorum. This result is expected because of the high rate at which brokers vote. In contrast, nearly 60 percent of shareholder meetings that contained at least one non-routine matter required at least one re-solicitation of shareholders (Figure 7).

Figure 7
Re-Solicitations of Shareholder Meetings With at Least
One Non-Routine Matter



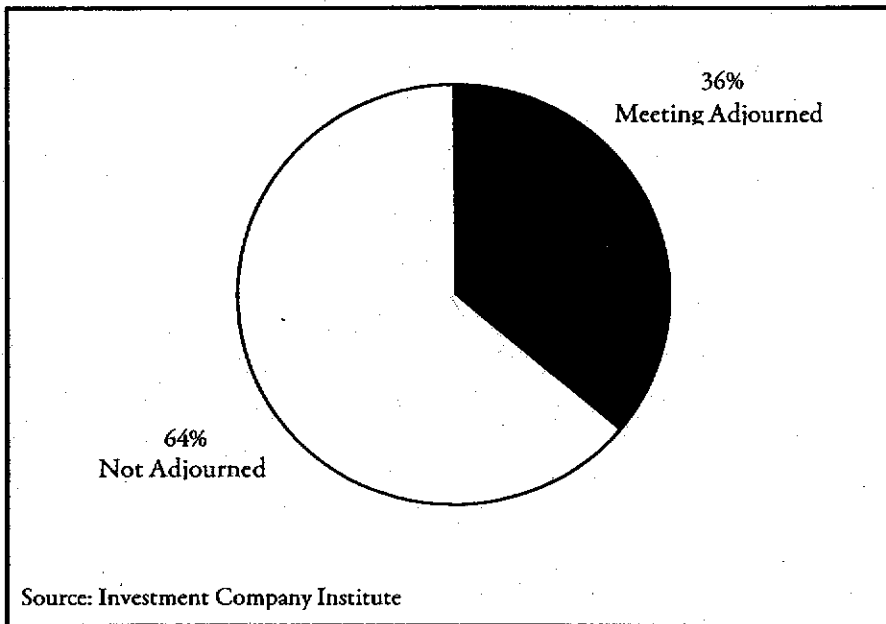
Funds that must re-solicit shareholders can expect, on average, to have to contact shareholders between 2 to 3 times to obtain quorum. Tabulations by both ADP and the Institute are reasonably consistent with one another (Figure 8). The maximum number of re-solicitations in the Institute's survey was 5 re-solicitations of shareholders.

Figure 8
Average Number of Re-Solicitations of Shareholders



Despite re-solicitation efforts, some funds needed to adjourn shareholder meetings due to insufficient voting response by shareholders. Based on the Institute's survey, a little more than one-third of shareholder meetings with at least one non-routine matter were adjourned (Figure 9).

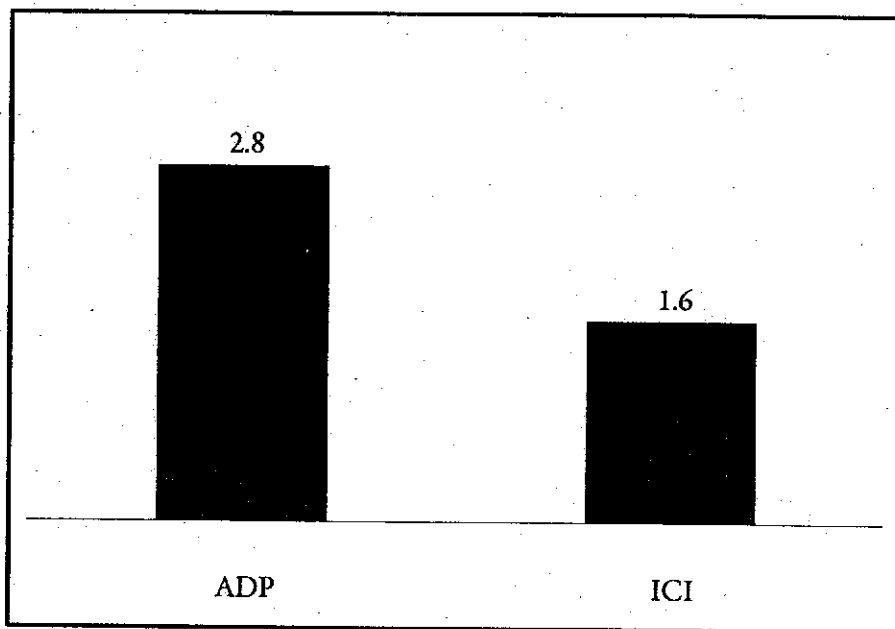
Figure 9
Adjournments of Shareholder Meetings With at Least
One Non-Routine Matter



Funds that must adjourn shareholder meetings can expect, on average, to adjourn roughly between 2 to 3 times. As shown in Figure 10, tabulations by both ADP and the Institute again are reasonably consistent with one another. In ADP's analysis, one fund experienced a maximum of 17 adjournments of a shareholder meeting. The Institute's survey had a maximum of 5 adjournments of a shareholder meeting.

Figure 10

Average Number of Times Shareholder Meetings Were Adjourned



Impact on Fund Industry from Eliminating Discretionary Broker Voting

We assessed the impact on the fund industry from eliminating discretionary broker voting by:

- Estimating the increase in proxy costs for funds based on the typical voting response by fund shareholders under routine and non-routine scenarios;
- Estimating increases in fund expense ratios based on a range of voting responses by fund shareholders under a non-routine scenario; and
- Analyzing the competitive effect on small fund advisers.

PROXY COSTS FOR FUNDS WILL RISE SUBSTANTIALLY

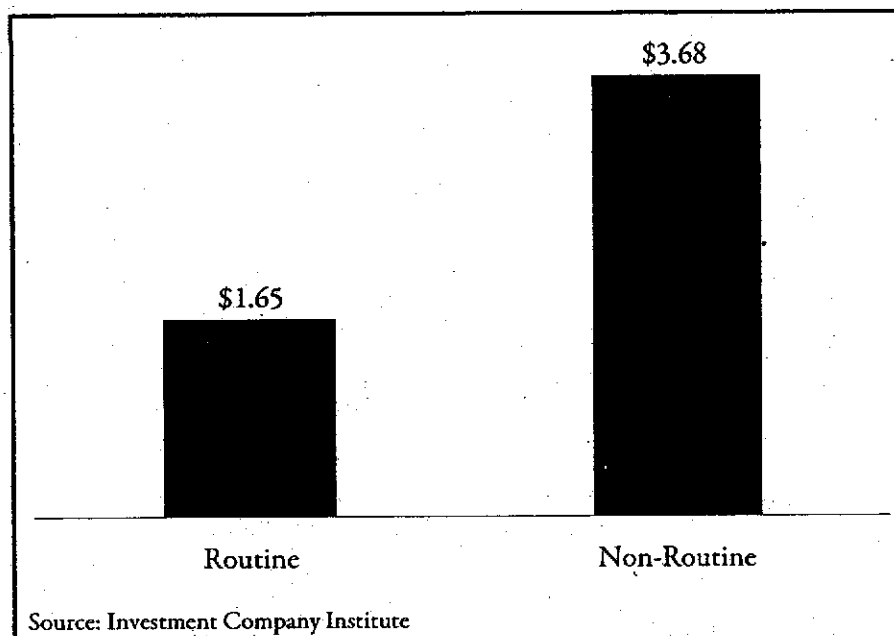
If brokers are not permitted to exercise discretionary voting authority on uncontested elections of directors, we estimate that typical proxy costs will more than double from \$1.65 per shareholder account to \$3.68 per shareholder account (Figure 11). In order to assess the impact of eliminating discretionary broker voting, we examined proxy costs in two scenarios. The baseline scenario, which we call "Routine," is one in which all items on the shareholder agenda are routine and brokers are allowed to vote.¹⁰ The other scenario, which we call "Non-Routine," is when there is at least one non-routine item on the shareholder meeting slate.¹¹ For ease of comparison, we scaled the proxy costs by shareholder accounts.¹² More detailed results of our analysis are shown in Table 1.

¹⁰ Based on the Institute's survey, shareholder meetings with a routine slate are fairly common. Roughly one-third of the 105 shareholder meetings had a routine slate. In nearly all of the routine meetings, shareholders were voting on the election of directors.

¹¹ The results are little changed if we only examine shareholder meetings in which all items on the shareholder agenda are non-routine. The presence of even one non-routine matter on the shareholder agenda significantly increased proxy costs.

¹² We derived cost estimates per shareholder account by looking through street holdings to the number of accounts held by beneficial owners. When possible, ADP provided the number of proxy items mailed—a good indicator of the number of shareholder accounts when ADP handled the entire proxy solicitation. The ADP figures also took into consideration householding, a common practice used to reduce mailing costs by bundling multiple proxy materials that are sent to a single address. When figures from ADP were unavailable or ADP did not handle the entire proxy solicitation, we used confidential data submitted to ICI on number of shareholder accounts by share class for mutual funds. We also examined the number of shareholder accounts reported on Form N-SAR filed with the SEC. If we found that we still did not have an accurate measure of shareholder accounts, we eliminated the proxy costs associated with those accounts from the analysis.

Figure 11
Fund Proxy Costs Per Shareholder Account
Median



Given the difficulties that funds face in obtaining votes from shareholders, funds often engage a third-party proxy solicitor to strategize timing, mailing, and phone follow-ups to help funds achieve a quorum. The Institute's survey collected all-in proxy costs for shareholder meetings. These proxy costs included charges for printing, mailing, and any services provided by proxy solicitors hired by the fund. We believe that the fund complexes that completed the Institute's survey are representative of the industry's experience with proxy voting by shareholders. As shown in Figures 8 and 10, ICI and ADP's figures on average number of re-solicitations and adjournments were quite comparable.

Several factors, all of which stem from shareholders' failure to vote, contribute to the increased proxy costs for Non-Routine shareholder meetings. One factor that can add up to \$0.60 cents per item mailed is that funds frequently will send proxy materials that contain non-routine matters to shareholders via first class mail rather than at the cheaper bulk rate.¹³ First

¹³ Many funds send proxy materials with only routine items to shareholders at bulk rate, which depending on the weight of the package can be considerably less expensive than first class mail. For example, a one-page letter with a proxy postcard typically costs \$0.28 to mail at the bulk rate. The same package typically costs \$0.87 to mail at the first class rate. We do not have data on the frequency with which fund shareholders have consented to receive proxy materials electronically. For those shareholders that have opted for e-delivery, proxy solicitation costs would be less than for those who receive materials by regular mail.

class mail is faster than bulk mail. Understandably, many funds seek to take advantage of the full proxy period before the shareholder meeting so that if re-solicitations are necessary there will be sufficient time to avoid an adjournment.

Re-soliciting shareholders to encourage them to vote is expensive.¹⁴ Besides sending additional mailings at the first class rate, funds may re-send proxy materials to shareholders by overnight delivery in an effort to obtain their vote by the deadline. Proxy costs escalate when funds have to use phone solicitation to persuade shareholders to vote. For example, one fund in the Institute's survey had a maximum of \$9.97 per shareholder account in proxy costs (Table 1). For this fund, phone solicitation accounted for 44 percent of its total proxy costs of approximately \$172,000.

In addition, funds can spend far more than expected on proxy solicitations. One major fund complex that conducted a complex-wide proxy solicitation estimated total proxy costs of \$5.2 million in their definitive proxy material filings with the SEC. After 4 re-solicitations of shareholders and 2 meeting adjournments, proxy costs ultimately amounted to \$19.2 million—3.7 times the original estimate.

Table 1
Fund Proxy Costs Per Shareholder Account

Minimum	\$0.95	\$1.12
25 th Percentile	\$1.27	\$2.76
Median	\$1.65	\$3.68
75 th Percentile	\$2.39	\$5.54
Maximum	\$3.42	\$9.97
Mean	\$1.85	\$4.37
Number of Meetings	26	57
Source: ICI calculations based on proxy costs from ICI Survey of Shareholder Voting and number of shareholder accounts from ADP, N-SAR, and confidential internal ICI data.		

¹⁴ Even if the OBO/NOBO distinction were eliminated, allowing funds to contact all of their shareholders directly "to get out the vote," re-solicitations still would be costly.

MANY SHAREHOLDERS WILL PAY MORE IN FUND EXPENSE RATIOS

Ultimately, fund shareholders will bear much of the burden of increased proxy solicitation costs. Fund expense ratios will increase if discretionary broker voting is disallowed for uncontested elections of directors, and if no other component of fund expenses declines. Typically, funds pay proxy costs, particularly for the election of directors, as part of the fund's total expenses.¹⁵

We conservatively estimate that fund expense ratios typically will rise between 1 to 2 basis points if funds have to change the treatment of an uncontested election of directors from a routine matter to a non-routine matter. For equity mutual funds, their expense ratios could increase as much as 5 basis points or more. In Tables 2 through 4, we provide a range of outcomes for the estimated increase in fund expense ratios for closed-end funds, equity mutual funds, and bond mutual funds.

In each case, the amount of the anticipated increase in the expense ratio of a given fund depends on two key factors: (1) the average account size; and (2) the amount of the increase in proxy costs per account. In short, the increase in the expense ratio will be larger when average account sizes are smaller and the increase in proxy costs is higher.

In the example provided below, we describe the calculation that is the basis for each of the figures shown in Tables 2 through 4. Closed-end fund shareholders typically pay about 117 basis points in fees and expenses.¹⁶ For an average account size of \$22,000, this translates into \$257.40 in fees and expenses each year.¹⁷ Closed-end funds are required to hold annual shareholder meetings in which they must elect the board of directors. Often, this is the only matter presented for shareholder approval. Consequently, current total fees and expenses of a closed-end fund most likely include proxy costs under a Routine scenario, which we estimate to be a median of \$1.65 per shareholder account. If discretionary broker voting for uncontested elections of directors is disallowed, we estimate that the median proxy cost will increase to \$3.68 per shareholder account. To assess the impact of this proposal on the expense ratio, we recalculated total fees and expenses under a Non-Routine scenario, holding management fees and other expenses constant. In this case, fees and expenses increase to \$259.43 per year, pushing up the asset-weighted average annual expense ratio by nearly 1 basis point.

¹⁵ These proxy costs are generally included in the fund's annual operating expenses under the category "Other Expenses" listed on Form N-1A filed with the SEC. Occasionally, the fund's adviser will assume all or part of the proxy costs. In some instances, the sub-adviser will assume the proxy costs for the approval of a new sub-advisory agreement.

¹⁶ To assess the costs investors currently pay across all closed-end funds, we used the asset-weighted average expense ratio for all closed-end funds.

¹⁷ $\$22,000 \cdot 0.0117 = \257.40 .

Example

Closed-end funds

Asset-weighted expense ratio = 117 basis points¹⁸

Average account size = \$22,000¹⁹

	ROUTINE	NON-ROUTINE
Management Fees & Other Expenses	\$255.75	\$255.75
Proxy Costs	\$1.65	\$3.68
Total Fees & Expenses	\$257.40	\$259.43

Expense ratio under non-routine scenario = $(\$259.43/\$22,000)*10,000 = 117.9$ basis points.

Change in the expense ratio = $117.9 - 117 = 0.9$ basis point.

As noted above, this calculation depends on the average account size and the amount of the increase in proxy costs. In the example shown above, the average account size of \$22,000 was from one large closed-end fund complex. Other closed-end funds may have smaller or larger average account sizes.²⁰ For demonstration purposes, let's assume that one-quarter of closed-end funds have average account sizes of \$11,000 (one-half of the \$22,000), and one-quarter of closed-end funds have average account sizes of \$44,000 (double the \$22,000).

As shown in Table 2, for closed-end funds with an \$11,000 average account balance, shareholders can expect the expense ratios of their fund to rise between 1 to 3.5 basis points. This range reflects the varying degrees of shareholder response in voting their proxies. If shareholders vote fairly readily, they likely will incur a \$2.76 per account charge (the 25th percentile cost of a Non-Routine proxy), which would increase the fund's annual expense ratio by one basis point. However, if greater efforts such as phone solicitations and multiple mailings are required to obtain shareholder votes, then shareholders could easily incur a \$5.54 (the 75th percentile cost of a Non-Routine proxy) or more per account charge, which would increase the fund's expense ratio by at least 3.5 basis points.

¹⁸ Figure based on ICI calculations of expense data for 2005 from Strategic Insight Simfund 4.0 database.

¹⁹ Figure based on calculation from a large closed-end fund complex.

²⁰ Research conducted by the Institute in 1998 indicated that the median amount of household financial assets held in closed-end funds was \$12,000, while the average was \$41,500 (ICI Fundamentals, U.S. Household Ownership of Closed-End Fund in 1998, April 1999).

Table 2**Range of Estimated Increase in Expense Ratios from Eliminating Discretionary Broker Voting**

Closed-End Funds

Asset-Weighted Expense Ratio = 117 basis points¹

	+1.0 bp	+0.5 bp	+0.3 bp
	+1.8 bp	+0.9 bp	+0.5 bp
	+3.5 bp	+1.8 bp	+0.9 bp

1. Figure based on ICI calculations of expense data for 2005 from Strategic Insight Simfund 4.0 database.
 2. Figures are the 25th percentile, median, and 75th percentile of proxy costs per shareholder account of a non-routine slate from Table 1.
 3. Figure based on a calculation from a large closed-end fund complex.

Equity mutual fund shareholders typically pay 90 basis points in fees and expenses. Our analysis suggests that, for half of equity mutual funds, expense ratios are likely to increase by 1.8 basis points when they are required to elect a board of directors without discretionary broker voting (Table 3). For one-fourth of equity mutual funds with average account balances of \$7,400 or less, expense ratios could increase by a little more than 5 basis points if shareholders are more apathetic about voting. For one-fourth of equity mutual funds with average account balances of at least \$17,600, expense ratios are expected to increase anywhere from 0.6 basis points to 2.2 basis points, depending on shareholder voting responses.

Table 3**Range of Estimated Increase in Expense Ratios from Eliminating Discretionary Broker Voting**Equity Mutual Funds¹Asset-Weighted Expense Ratio = 90 basis points²

	+1.5 bp	+1.0 bp	+0.6 bp
	+2.7 bp	+1.8 bp	+1.2 bp
	+5.3 bp	+3.4 bp	+2.2 bp

1. Includes hybrid mutual funds.
 2. Figure based on ICI calculations using expense data by share class for 2005 from Lipper LANA 4.0 database.
 3. Figures are the 25th percentile, median, and 75th percentile of proxy costs per shareholder account of a non-routine slate from Table 1.
 4. Figures are the 25th percentile, median, and 75th percentile of ICI calculations of the average account size by fund from account level data in non-variable annuity retail equity and hybrid mutual funds collected by ICI.

These expected increases in equity mutual fund expense ratios from eliminating discretionary broker voting are about on par with the cost of custody services and audit fees paid by many equity mutual funds.²¹ For example, half of equity mutual funds have custody fees that account for at least 2½ basis points on their expense ratios. Custody fees range from at most 1 basis point for one-quarter of equity mutual funds to at least 6 basis points for another quarter of equity mutual funds. Half of equity mutual funds have audit fees that account for at least 1½ basis points on their expense ratios. Audit fees range from at most ½ basis point for one-quarter of equity mutual funds to at least 4 basis points for another quarter of equity mutual funds.

Shareholders of bond mutual funds typically pay 70 basis points in fees and expenses. Our analysis suggests that, for half of bond mutual funds, expense ratios are likely to increase by 1.4 basis points when they are required to elect a board of directors without discretionary broker voting (Table 4). For one-fourth of bond mutual funds with average account balances of \$10,400 or less, expense ratios could increase by as much as 3.7 basis points. For one-fourth of bond mutual funds with average account balances of at least \$19,600, expense ratios are expected to increase anywhere from 0.6 basis points to 2 basis points, depending on shareholder voting responses.

Table 4
Range of Estimated Increase in Expense Ratios from Eliminating Discretionary Broker Voting
Bond Mutual Funds
Asset-Weighted Expense Ratio = 70 basis points¹

	+1.1 bp	+0.8 bp	+0.6 bp
	+2.0 bp	+1.4 bp	+1.0 bp
	+3.7 bp	+2.7 bp	+2.0 bp

1. Figure based on ICI calculations using expense data by share class for 2005 from Lipper LANA 4.0 database.
2. Figures are the 25th percentile, median, and 75th percentile of proxy costs per shareholder account of a non-routine slate from Table 1.
3. Figures are the 25th percentile, median, and 75th percentile of ICI calculations of the average account size by fund from account level data in non-variable annuity retail bond mutual funds collected by ICI.

²¹ The following figures are ICI calculations using data from Strategic Insight Simfund 4.0 MF database.

SMALL FUND ADVISERS WILL BEAR A SIGNIFICANT BURDEN²²

Small fund advisers are likely to bear a significant burden from the elimination of discretionary broker voting for three reasons.

First, economies of scale in additional costs per account work to the disadvantage of small funds. Small funds, even if they conduct complex-wide proxies, are less able to take advantage of volume discounts in printing and mailing because they have fewer shareholders.²³ Thus, on a per-account basis, the additional proxy costs are likely to be higher for small funds compared to large funds.

Second, expense ratios are already higher than average for small funds.²⁴ Even higher expense ratios are likely to make these funds less attractive to potential and existing shareholders, leading them to seek out lower cost funds.²⁵ To avoid increasing expense ratios, small fund advisers often pay costs out of their own pockets that typically are charged to a fund. Similarly, many small fund advisers enter into expense cap agreements, under which they agree to limit the expenses charged to a fund, paying any excess costs themselves. Advisers may also offer fee waivers. While large and small funds offer fee waivers with similar frequency, the waivers offered by small funds tend to be substantially higher.²⁶ These practices suggest that, for funds to attract and retain shareholders, there is essentially a market-imposed constraint on their expense ratios.

Finally, because many small fund advisers will feel compelled to absorb additional proxy costs, their profit margins will be squeezed further. Although figures on fund advisers' profitability are unavailable, anecdotal evidence suggests that small fund advisers operate under thin margins. The expected smaller rate of return on capital will dissuade some entrepreneurs from entering the mutual fund industry and push some fund advisers with thin profit margins to exit.

²² Small fund advisers are defined as fund complexes with less than \$2 billion in non-money market mutual fund assets.

²³ Many fund complexes combine shareholder meetings of individual funds into one complex-wide proxy to save on printing and distribution costs.

²⁴ See Appendix B in Letter from Members of Small Funds Committee, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated August 21, 2006.

²⁵ Investors can and do vote with their feet—in any given year, a quarter to a half of all mutual fund firms experience net outflows from long-term funds. Figure based on confidential data submitted to ICI for the monthly *Trends in Mutual Fund Activity* report.

²⁶ See Appendix C in Letter from Members of Small Funds Committee, Investment Company Institute, to Nancy M. Morris, Secretary, Securities and Exchange Commission, dated August 21, 2006.

Appendix
Investment Company Institute Survey on Shareholder Voting

Confidential Once Completed

July 7, 2006

SURVEY INSTRUCTIONS

For each one of the most recent four shareholder meetings held by your complex, please complete the following worksheets: (1) Fund Information for Shareholder Meeting and (2) Matter-Specific Information for Shareholder Meeting. If your complex has had fewer than four shareholder meetings in the past five years, please provide information for all shareholder meetings held in the past five years. Worksheets for four shareholder meetings have been provided for your convenience.

Fund Information for Shareholder Meeting

For each shareholder meeting, answers to items (4) through (7) may be available from your fund's transfer agent.

Matter-Specific Information for Shareholder Meeting

For each shareholder meeting, please provide information for all matters presented for a shareholder vote on a matter-by-matter basis. We have provided space for four matters per shareholder meeting. If you require additional space, please make a copy of a blank worksheet and indicate that the information is a continuation of a previous worksheet.

For item (8), please provide a brief description of the matter presented at the shareholder meeting. Some examples would be "election of directors", "approval of advisory contract", or "change in fundamental policies."

Since quorum requirements may vary by matter, please report the quorum requirement used for the specific matter in item (9).

For item (10), please report which one of the four options defined below was used as the standard of voting for the specific matter at the annual or a special shareholder meeting.

1. **Super-Majority:** 67 percent or more of the voting securities present at such meeting, if the holders of more than 50 percent of the outstanding voting securities of such fund are present or represented by proxy.
2. **Majority Vote:** more than 50 percent of the outstanding voting securities of the fund.
3. **Affirmatively Cast:** more than 50 percent of votes affirmatively cast (i.e., abstentions and broker non-votes are not counted in determining whether a majority of votes cast have approved a matter).
4. **Other:** any voting standard that does not fit in the three categories defined above.

For items (11) through (16), your transfer agent may be able to provide the necessary information. Also, items (17) through (19) are critical. Please provide as much information as possible on your number of re-solicitations (e.g., how many mailings), number of adjournments, and proxy solicitation costs.

If you have any questions regarding the survey, please contact Shelly Antoniewicz at (202) 326-5910 or at rantoniewicz@ici.org.

PLEASE RETURN SURVEY BY JULY 31, 2006.

Please enter the information into this document and return by electronic mail to Shelly Antoniewicz at rantoniewicz@ici.org or if you prefer, you can fax the information to her at (202) 326-5924. Thank you for your assistance in this project.

FIRM INFORMATION AS OF JUNE 30, 2006

Name of firm: _____
1940 Investment Company Act registered assets (millions of dollars): _____
Number of 1940 Act registrants (trusts/series) filing with the SEC: _____
Total number of funds (portfolios) included in previous answer: _____
Over the past five years, please report for your complex
(a) Total number of funds that held shareholder meetings: _____
(b) The total number of shareholder meetings held by these funds: _____

CONTACT INFORMATION

Name of individual filling out survey: _____
Contact phone: _____
Contact email: _____

Fund Information for Shareholder Meeting #1

1. Name of fund: _____
2. Type of fund: Open-end: _____ Closed-end: _____
3. Date of shareholder meeting: _____
4. Number of fund shares outstanding on record date: _____
5. Number of shares held by "objecting beneficial owners"* on record date: _____
6. Percent of shareholders that were "objecting beneficial owners" on record date: _____
7. Number of shares held in nominee name by NYSE members on record date: _____

* Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs."

Matter-Specific Information for Shareholder Meeting #1

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations ¹				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

Fund Information for Shareholder Meeting #2

1. Name of fund: _____
2. Type of fund: Open-end: _____ Closed-end: _____
3. Date of shareholder meeting: _____
4. Number of fund shares outstanding on record date: _____
5. Number of shares held by "objecting beneficial owners" on record date: _____
6. Percent of shareholders that were "objecting beneficial owners" on record date: _____
7. Number of shares held in nominee name by NYSE members on record date: _____

* Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs."

Matter-Specific Information for Shareholder Meeting #2

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations ¹				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

Fund Information for Shareholder Meeting #3

1. Name of fund: _____
2. Type of fund: Open-end: _____ Closed-end: _____
3. Date of shareholder meeting: _____
4. Number of fund shares outstanding on record date: _____
5. Number of shares held by "objecting beneficial owners" on record date: _____
6. Percent of shareholders that were "objecting beneficial owners" on record date: _____
7. Number of shares held in nominee name by NYSE members on record date: _____

* Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs."

Matter-Specific Information for Shareholder Meeting #3

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations ¹				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

Fund Information for Shareholder Meeting #4

1. Name of fund: _____
2. Type of fund: Open-end: _____ Closed-end: _____
3. Date of shareholder meeting: _____
4. Number of fund shares outstanding on record date: _____
5. Number of shares held by "objecting beneficial owners" on record date: _____
6. Percent of shareholders that were "objecting beneficial owners" on record date: _____
7. Number of shares held in nominee name by NYSE members on record date: _____

* Shareholders who object to having their names and addresses disclosed to issuers are called "Objecting Beneficial Owners" or "OBOs."

Matter-Specific Information for Shareholder Meeting #4

	Matter #1	Matter #2	Matter #3	Matter #4
8. Brief description of matter submitted for shareholder vote				
9. Quorum requirement				
10. Standard used for voting				
11. Can NYSE member vote without customer instruction?				
12. Number of voted shares				
13. Number of voted shares held in nominee name by NYSE members				
14. Number of "For" votes				
15. Number of "Against" votes				
16. Number of abstentions				
17. Number of re-solicitations				
18. Number of adjournments				
19. Total cost of proxy solicitations ¹				

1. Include costs of repeated solicitation efforts, such as internal staff time and/or use of proxy solicitor.

