UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of the

New York Stock Exchange LLC

Regarding an Order Disapproving a

Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners (File No. SR-NYSE-2020-96)

INVESTMENT COMPANY INSTITUTE'S STATEMENT IN OPPOSITION TO THE DISAPPROVAL OF NYSE'S PROPOSED RULE CHANGE AND URGING THE COMMISSION TO SET ASIDE THE DISAPPROVAL ORDER

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The Investment Company Institute (ICI)[1] respectfully submits this statement in opposition to the order issued by the Securities and Exchange Commission's Division of Trading and Markets (the "Division"), under delegated authority, disapproving the New York Stock Exchange's (NYSE) proposed rule change on maximum fees to be charged by member organizations for forwarding proxy and other materials to beneficial owners.[2]

PRELIMINARY STATEMENT

While NYSE's proposed rule change focused on a narrow request to transfer oversight of processing fees to the Financial Industry Regulatory Authority (FINRA), the Commission should use its review of the Disapproval Order to reevaluate the broader processing fee framework, which currently forces investors in registered investment companies[3] to pay excessive and unreasonable fees to receive SEC-required disclosure documents.

Intermediaries, such as broker-dealers, charge funds processing fees to handle the delivery of SEC-required disclosure documents to the fund's investors. SEC rules permit broker-dealers and other intermediaries to seek *reasonable* reimbursement for providing this service. The problem is that instead of charging reasonable fees, broker-dealers charge funds the *maximum* amount that appears in NYSE's fee schedule, regardless of the actual cost of delivering the materials. Broker-dealers generally outsource their obligation to provide fund materials to a vendor that then invoices the fund for payment. Since funds bear

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[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 $33.1 trillion in the United States, serving more than 100 million US shareholders, and $9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] Order Disapproving a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-92700 (Aug. 18, 2021), 86 FR 4735l (Aug. 24, 2021) ("Disapproval Order"), *available at* https://www.sec.gov/rules/sro/nyse/2021/34-92700.pdf.

[3] We refer to registered investment companies herein as "investment companies" or "funds."

the cost, broker-dealers simply have no incentive to negotiate with the vendor to secure lower prices for fund investors and, in many cases, benefit from keeping these fees high. The Division's rejection of NYSE's proposed rule change maintains the status quo, effectively perpetuating unreasonably high costs for fund investors to receive SEC-required disclosures.

In the Disapproval Order, the Division stated that the process for determining NYSE's fee schedule results in "reasonable" processing fees. ICI's membership emphatically disagrees, and our research shows that the current fees are by no means reasonable and are often unrelated to the actual cost of delivering fund materials. Importantly, funds are charged significantly more to deliver materials through broker-dealers and their vendors than they pay to deliver the same materials through a vendor of their choosing.

The Division also declared that NYSE is best suited to oversee the processing fee framework even though NYSE has made it clear that it neither wants this responsibility nor has the ability to carry it out effectively. The Division asserted that NYSE should continue to perform this function because it is in the best position to consider the interests of broker-dealers and issuers, including mutual funds. The facts, however, do not support this conclusion. For instance, the current fee schedule was set over eight years ago through a process dominated by broker-dealers and their vendors. Even NYSE acknowledges that the current fees are "likely out of date." In addition, NYSE admits that it lacks the necessary relationship with mutual funds and other market participants to properly consider their interests in the rate setting process.

Ultimately, although the Division missed a key opportunity to address the underlying issues with the processing fee framework by rejecting NYSE's proposed rule change, the Commission now has an opening itself to take the necessary steps to reform this system in a way that protects fund investors.

For these reasons, and others discussed herein, the Commission should set aside the Disapproval Order and take the steps described below to repair the broken processing fee framework for the protection of investors, a core mission of the Commission. In the near term, the Commission should direct NYSE to make targeted changes to the current fee schedule to rationalize processing fees and eliminate unnecessary fees. In the long-term, the Commission should either eliminate the fee schedule and allow market forces to determine the prices for these services, or replace NYSE's fee schedule with a new and more competitive processing fee system under the Commission's direct oversight.

BACKGROUND

I. The Broken Processing Fee System

NYSE member organizations (*e.g.*, broker-dealers) are required to deliver fund materials to beneficial owners (*i.e.*, fund investors) who hold shares in nominee name (*i.e.*, the broker-dealer's name).[4] In exchange for the delivery of these documents to its investors, the fund must reimburse NYSE member organizations for out-of-pocket, *reasonable* clerical, postage and other expenses, according to NYSE's fee schedule.[5] The Commission explained that this reimbursement structure stems from Rules 14b-1 and 14b-2 under the Securities Exchange Act of 1934 ("Exchange Act"), which "do not specify the fees that nominees can charge issuers for proxy distribution; rather they state that issuers must reimburse the nominees for 'reasonable expenses' incurred."[6] Neither NYSE nor SEC rules define what constitutes "reasonable" fees.

[4] See NYSE Rules 451 and 465. ICI research shows that in 2021, 97 percent of households purchased shares primarily through intermediaries, while only three percent of households reported that they primarily purchased mutual funds directly from the mutual fund company. *See* Profile of Mutual Fund Shareholders, 2021, *ICI Research Report*, at Figure 4.1 (December 2021), *available at* https://www.ici.org/system/files/2021-12/21_rpt_profiles.pdf. When an intermediary purchases fund shares for their customers, fund records identify the intermediary as the record owner.

[5] For years, the Commission has relied on self-regulatory organizations (SROs), such as NYSE, to establish the fees that funds and other issuers must pay to reimburse intermediaries for delivering regulatory materials. NYSE historically has taken the lead in establishing the fee schedule. *See* Order Approving Proposed Rule Change, Release No. 34-21900 (Mar. 28, 1985), 50 FR 13297 (Apr. 3, 1985) *available at* https://archives.federalregister.gov/issue_slice/1985/4/3/13296-13299.pdf#page=2. FINRA and NASDAQ Stock Market (NASDAQ) have adopted rules mirroring NYSE's rules for the fee framework. *See* FINRA Rule 2251; and NASDAQ Rule 2251.

[6] Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-91359 (Mar. 18, 2021), 86 FR 15734 (Mar. 24 2021) ("2021 Order Instituting Proceedings") at 1-5, *available at* https://www.sec.gov/rules/sro/nyse/2021/34-91359.pdf.

Broker-dealers generally outsource their obligation to forward fund materials to a vendor of their choice, who then invoices the fund for the amount charged. Notably, that charge is a fund expense that is directly borne by fund shareholders. The NYSE fee schedule sets a cap on the maximum "reasonable" reimbursement that broker-dealers can charge funds for "processing" regulatory materials. Funds, however, are almost always charged the maximum rate regardless of the actual cost of delivering the materials. This demonstrates that, with funds footing the bill, broker-dealers have no incentive to negotiate lower rates for the benefit of funds and their investors.

When the broker-dealer negotiates a rate with the vendor that is lower than the NYSE-set maximum rate, the fund generally does not receive the lower rate. Instead, the vendor typically bills the fund for the maximum rate allowed under NYSE's fee schedule and then "remits" a portion of the fund's payment back to the broker-dealer, thereby sharing the profit. Ultimately, these payments represent a significant source of revenue for broker-dealers and the vendors they hire.

In fact, our research shows that funds *pay three to five times as much* to distribute materials through intermediaries as they pay to distribute those materials directly,[7] costing fund investors *approximately $220 million in additional expenses annually*.[8] Data collected through an ICI member survey found that the median fund pays 5 cents to send a shareholder report—whether by US mail or email—to accounts it holds directly. Yet, based on the same survey data, the leading vendor used by broker-dealers charges 15 cents to send the identical shareholder report by mail and an even higher 25 cents to send it by email.[9] Such a cost

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[7] Letter from Susan Olson, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, US Securities and Exchange Commission (Oct. 31, 2018) ("ICI 2018 Letter"), *available at* https://www.ici.org/system/files/attachments/18_ici_processing_fees_ltr.pdf (describing results of a survey of 1704 mutual funds managed by 50 ICI member firms).

[8] Letter from David Blass, General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, US Securities and Exchange Commission B-6 (Oct. 31, 2015), *available at* https://www.ici.org/system/files/attachments/pdf/15_ici_sec_reporting_modernization_ltr.pdf.

[9] That vendor, Broadridge Financial Solutions, has presented data and analysis suggesting that total costs to distribute fund materials to investors in intermediary-held accounts are not higher than for accounts held directly by the fund. *See* Letter from Charles V. Callan, Senior Vice President, Regulatory Affairs, Broadridge Financial Solutions, Inc. to Brent J. Fields, Secretary, US Securities and Exchange Commission (Oct. 31, 2018), *available at* https://www.sec.gov/comments/s7-13-18/s71318-4593946-176328.pdf. ICI has explained that Broadridge's analysis

discrepancy demonstrates that the current processing fee framework is ill-suited to distribution of fund materials and that the fees are largely unrelated to the actual cost of delivering SEC-required disclosures to fund investors.[10]

One explanation for the flawed processing fee schedule is that broker-dealers and their vendors controlled the process that created it.[11] The current fee schedule reflects recommendations from the Proxy Fee Advisory Group (PFAC).[12] The PFAC consisted of issuers, broker-dealers, one mutual fund company, and NYSE representatives. The PFAC's recommendations primarily relied on the limited public information about the predominant vendor's profitability as well as the vendor's own analysis of whether the NYSE fees aligned with its work effort. NYSE submitted the 2013 rule proposal (which ultimately resulted in the current fee schedule) to the Commission based on its belief that the changes would result in lower fees overall, and this representation seems to have been an important factor for the SEC in approving the updated fee schedule.[13]

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was flawed because it did not specifically address processing fees, as those costs were bundled into the total cost calculation. This obscured the higher processing fees charged to intermediary-held accounts as compared to accounts held directly with a fund. Importantly, ICI's examination of Broadridge's analysis shows that Broadridge charges less for direct-at-fund accounts than would be assessed under the NYSE processing fee schedule for intermediary-held accounts with the same characteristics. *See* Letter from Shelly Antoniewicz, Senior Director of Industry and Financial Analysis, and Joanne Kane, Senior Director of Operations & Transfer Agency, Investment Company Institute, to Brent J. Fields, Secretary, US Securities and Exchange Commission (Jan. 17, 2019) ("ICI Compass Lexecon Letter"), *available at* https://www.sec.gov/comments/s7-13-18/s71318-4844298-177198.pdf.

[10] For example, for intermediary-held accounts, the NYSE's processing fee schedule allows broker-dealers to charge funds a premium to "suppress" (not mail) fund materials, known as the "preference management fee." This fee was designed to reimburse brokers (and thus the vendor) for "significant processing work involved in keeping track of the shareholder's election [to receive fund materials electronically or in paper]," even though the Commission's last review acknowledged that few shareholders actually change their election. ICI 2018 Letter at 13 (citing Order Instituting Proceedings to Determine Whether to Disapprove Proposed Rule Change Amending NYSE Rules 451 and 465, Release No. 34-69622 (May 23, 2013) 78 FR 32510 (May 30, 2013), at 51, *available at* https://www.sec.gov/rules/sro/nyse/2013/34-69622.pdf).

[11] *See* ICI 2018 Letter at Appendix A.

[12] The PFAC's recommendations were part of a report that also highlighted the differences between the processing fees charged to funds and those charged to operating companies; the PFAC's recommendations, however, did not include changes to the fees charged for distributing fund materials. *Id*. at A-3.

[13] *See id*. at A-4.

ICI submitted comment letters in March and June 2013 raising serious concerns with NYSE's 2013 proposed rule changes, emphasizing the problems with the current fee framework, opposing aspects of NYSE's rule proposal that failed to create an incentive to reduce fees, and reiterating the need for an independent review of the fee structure.[14] While the Commission went on to approve NYSE's rule change in October 2013 without addressing ICI's concerns,[15] the Commission noted its expectation that NYSE would "periodically review the fees to ensure that they are related to the reasonable expenses of the NYSE member firms."[16] The PFAC similarly recommended revisiting the fee schedule in three years (*i.e.*, 2016) to ensure that the fees were operating as the predominant vendor represented.[17] Regrettably, despite the Commission's stated expectation and the PFAC's recommendation, such a review of the fees never took place.[18]

II. Procedural History

On December 2, 2020, NYSE submitted a proposed rule change, which the Commission published for public comment on December 15, 2020.[19] On February 1, 2021, the Commission set a longer time to take action on the proposal.[20] On March 18, 2021, the Commission instituted proceedings to determine

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[14] *See id*.

[15] *See id*. (citing Order Granting Approval to Proposed Rule Change Amending NYSE Rules 451 and 465, Release No. 34-70720 (Oct. 18, 2013), 78 FR 63530 (Oct. 24, 2013) ("2013 Approval Order"), *available at* https://www.sec.gov/rules/sro/nyse/2013/34-70720.pdf (order approving NYSE amendments to rules governing proxy expense reimbursement schedule)).

[16] 2013 Approval Order at 1-6.

[17] ICI 2018 Letter at Appendix A.

[18] *Id*.

[19] *See* Notice of Filing of Proposed Rule Change Amending its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-90677 (Dec. 15, 2020), 85 FR 83119 (Dec. 21, 2020) (notice of filing of proposed NYSE amendments to rules governing proxy expense reimbursement schedule) ("NYSE's Proposed Rule Change"), *available at* https://www.sec.gov/rules/sro/nyse/2020/34-90677.pdf.

[20] *See* Notice of Designation of a Longer Period for Commission Action on a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-91025 (Feb. 1, 2021), 86 FR 8420 (Feb. 5, 2021), *available at* https://www.sec.gov/rules/sro/nyse/2021/34-91025.pdf.

whether to approve or disapprove the proposed rule change.[21] On June 11, 2021, the Commission designated a longer period for Commission action on NYSE's proposal.[22]

NYSE's proposed rule change would have eliminated the fee schedule and directed NYSE member organizations that are also FINRA member firms to comply with FINRA Rule 2251's fee schedule of approved charges for reimbursement rates for forwarding proxy and other materials to beneficial owners.[23] NYSE's fee schedule is functionally identical to FINRA's fee schedule. As the SEC acknowledged, these actions would have the effect of transferring to FINRA the responsibility for administering the fee schedule.[24] During the comment period on NYSE's rule proposal, however, FINRA filed a comment letter asserting that it "can firmly attest that [it is] not in [a better] position [to take a lead on this issue]."[25]

Disapproval Order

On August 18, 2021, the Division, pursuant to delegated authority, issued an order disapproving NYSE's proposed rule change.[26] The Division concluded that NYSE had failed to demonstrate that the proposed rule change would, as required by Section (6)(b)(5) of the Exchange Act, "promote just and

[21] *See* 2021 Order Instituting Proceedings.

[22] *See* Notice of Designation of a Longer Period for Commission Action on Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-92154 (June 11, 2021), 86 FR 32301 (June 17, 2021), *available at* https://www.sec.gov/rules/sro/nyse/2021/34-92154.pdf.

[23] *See supra* note 5.

[24] Disapproval Order at 7.

[25] *See* Letter from Marcia Asquith, Executive Vice President, Board & External Relations, FINRA, to Vanessa Countryman, Secretary, Securities and Exchange Commission at 3 (April 14, 2021), *available at* https://www.finra.org/sites/default/files/2021-04/FINRA_Comment_Letter_SEC_4-14-2021_File_No_SR-NYSE-2020-96.pdf

[26] Disapproval Order at 1.

equitable principles of trade, protect investors and the public interest, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers."[27]

In disapproving the proposed rule change, the Division strongly suggested that the current process for setting the fee schedule under NYSE's oversight, *de facto* yields reasonable fees. The Division declared that NYSE's "ability to duly consider both brokers' and issuers' interests…is critical to an equitable and fair process for determining what rates would constitute reasonable reimbursement."[28] The Division reasoned that NYSE's ability to consider both of those constituencies' interests allows it to generate "proposals [to update the fee schedule] that provide a basis for the Commission to find that the proposed updated rates constitute an equitable allocation of reasonable fees."[29]

The Division described the fee schedule "as a consensus product representing broker and issuer interests," stating that "consideration of issuers' interests has been a fundamental part of the" fee setting process.[30] As examples of NYSE's ability to achieve a "consensus view of the issuers and the broker dealers involved," the Division cited to NYSE's 2010 formation of the PFAC and to the 2013 revisions to NYSE's reimbursement schedule.[31]

The Division reached this conclusion despite NYSE's express statements that it does not want, and is not well suited, to carry out this responsibility and despite its acknowledgement that almost all

[27] *Id*. at 7.

[28] *Id*. at 12-13.

[29] *Id*.

[30] *Id*. at 12.

[31] *Id*.

commenters on the proposed rule change "urged comprehensive, Commission-led reform to the current reimbursement structure."[32]

NYSE's Petition for Review

On September 1, 2021, NYSE filed a petition for review of the Disapproval Order.[33] In the Petition for Review, NYSE again emphasized that it does not consider itself to be well positioned to oversee the processing fee framework, stating that "while [NYSE] may once have been a convenient forum to bring together all market participants with relevant views on proxy expense reimbursement rates, it no longer plays that role."[34] In doing so, NYSE noted that it "has no relationship with several classes of market participants involved in forwarding" SEC-required disclosures, including with mutual funds.[35]

The Petition for Review also recognized that numerous commenters on NYSE's proposed rule change said "that they want the *Commission* to get involved and reform the current [processing fee system] in a way that both accounts for the views of all stakeholders and ties proxy expense reimbursements to market forces"[36] The Petition for Review pointed out that "since the end of the last century, NYSE's proposed rate schedules have generated calls from market participants urging the Commission itself or an independent third party to conduct an impartial assessment of the [fee schedule]."[37] Likewise, NYSE noted

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[32] *See* Disapproval Order at 14 n. 52. On a technical point, the Division concluded that, "such reform [was] beyond the scope of this proposed rule change" and noted that NYSE did not intend its proposed rule change to "take a position on the appropriateness of the current fee schedule." *Id*.

[33] Petition of the New York Stock Exchange for Review of an Order Disapproving the New York Stock Exchange LLC's Proposed Rule Change to Amend its Rules Establishing Maximum Fee Rates to be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners (Sept. 1, 2021) ("Petition for Review"), *available at* https://www.sec.gov/rules/sro/nyse/2021/34-92700-20210901-nyse-petition-for-review.pdf.

[34] *Id*. at 3.

[35] *Id*. at 2, 20.

[36] *Id*. at 3

[37] *Id*. at 21.

that "[e]ven the Commission has repeatedly expressed its preference for a market-driven approach to proxy expense reimbursements, rather than rate-setting via SRO rulemaking."[38]

The Petition for Review additionally indicated that, while NYSE convened the PFAC in 2010 as part of the process of updating the fee schedule, the process "faced considerable skepticism from the Commission and opposition from commenters when the updated rates were proposed in 2013."[39] Further, NYSE highlighted that in 2013, "'the Commission emphasize[d] that it [was] continu[ing] to review the issues raised in the [NYSE proposal], 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.'"[40]

On January 7, 2022, the Commission approved the Petition for Review, ordering that interested persons file written statements in support of or opposition to the Disapproval Order on or before February 3, 2021.[41]

III. Standing and Applicable Legal Standards

ICI files this Statement pursuant to Commission Rule of Practice 431(d) opposing the Division's disapproval of NYSE's proposed rule change and urging the Commission to set aside the disapproval order.[42]

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[38] *Id*. (citing to 2013 Approval Order at 1-7.)

[39] *Id*. at 10 (citing to 2013 Approval Order at 1-7).

[40] *Id*. (quoting 2013 Approval Order at 68-70).

[41] Order Granting Petition for Review and Scheduling Filing of Statements Regarding an Order Disapproving Proposed Rule Change To Amend Its Rules Establishing Maximum Fee Rates To Be Charged by Member Organizations for Forwarding Proxy and Other Materials to Beneficial Owners, Release No. 34-93934 (Jan. 7, 2022), 87 FR 2189 (Jan. 13, 2022), *available at* https://www.sec.gov/rules/other/2022/34-93934.pdf.

[42] 17 C.F.R. § 201.43l(d) (stating that "any party or other person may file a statement in support of or in opposition to the action made by delegated authority").

In deciding on a petition for review that challenges the Division's disapproval of an SRO's rule pursuant to delegated authority, the Commission may "affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part" the disapproval order.[43] The Commission's review is *de novo* and must give careful consideration to the entire record – including the SRO rule proposal, the petition for review, and all comments and statements submitted – to determine whether the proposal is consistent with the Exchange Act and the rules and regulations issued thereunder.[44]

ARGUMENT

The Commission should set aside the Disapproval Order pursuant to Rule of Practice 431(a).

IV. The Disapproval Order's Rejection of NYSE's Proposal Preserves a System that Creates Perverse Incentives and Perpetuates Practices that Harm Fund Investors

The practical effect of the Division's Disapproval Order is to retain a broken system that is long overdue for reform. As detailed in the Background section, broker-dealers, in almost all cases, charge funds the maximum allowed under NYSE's fee schedule for delivering fund materials, even though that maximum may not be *reasonable*. In fact, many broker-dealers have a financial incentive, as do their vendors, to keep these fees high. This is because the higher the fee, the greater the amount of profit for the vendor and the broker to split (which the NYSE fee schedule identifies as "remittances"). Remittances are a stark example of the inequitable allocation of fees that takes place today.

The current processing fee system results in unreasonable outcomes like broker-dealers charging funds 25 cents for each disclosure document *emailed* to investors instead of the 5 cents charged to direct-

[43] 17 C.F.R. § 201.43l(a).

[44] *See* Order Setting Aside Action by Delegated Authority and Approving a Proposed Rule Change, as Modified by Amendments No. 1 and 2, to Introduce Cboe Market Close, a Closing Match Process for Non-BZX Listed Securities under New Exchange Rule 11.28, Release No. 34-88008 (Jan. 21, 2020), 85 FR 4726 (Jan. 27, 2020) ("BatsBZX Order Setting Aside Action"), *available at* https://www.sec.gov/rules/sro/batsbzx/2020/34-88008.pdf.

held accounts.[45] Similarly, 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.[46]

V. The Disapproval Order Erred in Declaring that the Current Processing Fee Framework Results in Reasonable Fees and Represents Funds' Interests

The Disapproval Order states that NYSE's "ability to duly consider both brokers' and issuers' interests…is critical to an equitable and fair process for determining what rates would constitute reasonable reimbursement," suggesting that the fees derived through such a process are *de facto* reasonable.[47] The Division's suggestion, however, contrasts sharply with ICI's research and NYSE's recognition that, given the "years that have elapsed since the rates were last updated and the sea of changes the industry has experienced, the [current fees] are 'likely out of date.'"[48] It is perplexing that the Division could conclude that the fees are "reasonable" when it was aware of ICI research showing that funds are being forced to pay significantly more to deliver materials through broker-dealers and their vendors than they pay to deliver the same materials directly.[49] This discrepancy is indicative of the unreasonableness of the current fees, as it shows that NYSE's processing fee framework is not well-suited to the distribution of fund materials and that the fees that funds pay bear little relation to the actual work and cost of delivering those materials.

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[45] ICI 2018 Letter at 6 (ICI research finding that the median fund pays five times as much to e-mail a shareholder report to an intermediary-held account as compared to a direct-held account).

[46] *Id*.

[47] Disapproval Order at 12-13.

[48] Petition for Review at 2, 11.

[49] *See* ICI 2018 Letter at 2. During the comment period on NYSE's rule proposal, ICI submitted two comment letters making this point, urging the Commission take action to reform the processing fee system, and providing both short-term and long-term recommendations on how the Commission could fix this system. *See* Letter from Dorothy Donohue, Deputy General Counsel, Securities Regulation, and Joanne Kane, Senior Director of Operations and Transfer Agency, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission (Jan. 8, 2021), *available at* https://www.ici.org/system/files/attachments/21_ltr_secfinra.pdf*;* Letter from Sarah Bessin, Associate General Counsel, and Joanne Kane, Senior Director of Operations and Transfer Agency, Investment Company Institute, to Vanessa Countryman, Secretary, US Securities and Exchange Commission, 4-6 (May 13, 2021), *available at* https://www.ici.org/system/files/2021-05/33531a.pdf.

The Disapproval Order also characterized the fee schedule "as a consensus product representing broker and issuer interests," and cited to NYSE's 2010 formation of the PFAC and to the 2013 revisions to NYSE's reimbursement schedule, as examples of NYSE's ability to consider brokers' and issuers' interests. The Division's conclusion, however, ignores that: (i) broker-dealers and their vendors dominated the process that resulted in the current fee schedule, and such process largely disregarded funds' perspectives and concerns;[50] (ii) in setting the fee rates, NYSE relied almost exclusively on vendor-provided data, with little consideration of third-party information or analysis;[51] and (iii) as NYSE pointed out, the process to determine the current fee schedule "faced considerable skepticism from the Commission and opposition from commenters."[52] The Commission need look no further than the underrepresentation of mutual funds on the PFAC and the resulting harm to fund shareholders, to see that the current fee schedule is by no means a "consensus product."

The Disapproval Order stated that the Commission does not have sufficient information to find that NYSE's proposal would promote just and equitable principles of trade and protect investors and the public interest, and not permit unfair discrimination between customers, issuers, brokers, or dealers. We assert that the *existing framework* also fails to promote just and equitable principles of trade and protect investors and the public interest, and permits unfair discrimination between customers, issuers, brokers, or dealers. Accordingly, we urge the Commission to develop a new approach that provides for updated rates that constitute an equitable allocation of reasonable fees.

VI. The Commission Must Directly Take Action to Reform the Broken Processing Fee Framework

While the basis for the Division's rejection of NYSE's proposed rule change seems misguided, without further reform, the underlying issues with the processing fee framework will remain, regardless of

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50 *See supra* p. 5; *see also* ICI 2018 Letter at Appendix A for a detailed history of the NYSE fee schedule.

51 *See supra* p .5; *see also* ICI 2018 Letter at Appendix A for a detailed history of the NYSE fee schedule.

52 Petition for Review at 10.

whether it is under NYSE or FINRA oversight, especially given that one SRO is seeking to shed this responsibility (in the case of the NYSE) and the other is explicitly refusing to assume it (in the case of FINRA).

In the Disapproval Order, the Division explicitly acknowledged that almost all commenters on the proposed rule change "urged comprehensive, Commission-led reform to the current reimbursement structure."[53] The Commission now has the opportunity to do so. We urge the Commission to step in to protect fund investors by directly addressing the underlying issues with the processing fee system that have led to broker-dealers and their vendors charging excessive and unreasonable fees. Only the Commission has the authority and perspective to independently assess the current framework and make the judgments necessary to reform it, consistent with the public interest and the Commission's statutory responsibilities to protect investors and maintain fair and orderly markets.

We recognize the urgency and the complexity of the undertaking and provide below paths that the Commission could take to repair the broken processing fee framework in the near term and long term.

A. Fixing the Processing Fee System in the Short Term

In the near term, the Commission can first give meaning to Exchange Act Rules 14b-1 and 14b-2 by issuing a statement reminding broker-dealers and their vendors that these rules require processing fees to be "reasonable" and that the maximum fees in NYSE's fee schedule are not *prima facie* evidence of reasonableness. Reasonableness should be determined with reference to the actual costs incurred to carry out the processing service as reflected in robust data that goes beyond data provided by the predominant vendor used by broker-dealers.

[53] Disapproval Order at 14 n. 52.

Additionally, if NYSE retains oversight, the Commission can repair the processing fee framework in the near term by ensuring that certain pointed changes are implemented.[54] Specifically, the Commission should direct the NYSE to file a proposal to modify the fee schedule to:

(a) rationalize the fees that broker dealers may charge for emailing fund materials;

(b) provide that any broker-dealer may not charge funds more than what the vendor charges the broker-dealer based on the actual costs of processing and delivering fund materials;[55]

(c) eliminate preference management fees from the NYSE fee schedule; and

(d) clarify that member firms cannot charge processing fees for any managed account[56] that does not receive fund materials.[57]

NYSE should no longer permit broker-dealers to charge unreasonable "processing fees" to deliver fund materials to investors. Funds are being forced to pay 3 to 5 times more to deliver materials through these firms and their vendors than they pay to deliver the same materials directly. These higher costs are borne by fund investors. Indeed, an ICI survey found that the median fund pays 5 cents to send a shareholder report—whether by US mail or email—to accounts it holds directly. Yet the leading vendor used by broker-dealers charges 15 cents to send the identical shareholder report by mail and an even higher 25 cents to send it by email. These unreasonable fees cost fund investors more than $220 million a year. Assertions that there are differences in the service models that justify these higher fees are specious.

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[54] In the event that the Commission decides to transfer oversight over the processing fee framework to FINRA, our recommendations with regard to making pointed changes to the fee schedule would apply to that SRO as well.

[55] We recommend that the SEC require broker-dealers to implement policies and procedures, and maintain books and records, with respect to such a requirement.

[56] 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 broker-dealers (and other intermediaries) sponsor managed account programs for investors who lack the expertise, time, or interest to manage their own investments directly. These investors delegate investment discretion and voting authority to the intermediary, who votes the proxies and makes the investment decisions. The SEC does not require intermediaries to deliver fund materials to these investors.

[57] Letter from Sarah A. Bessin, Associate General Counsel, and Joanne Kane, Senior Director, Operations and Transfer Agency, Investment Company Institute, to John Carey, Senior Director, NYSE (Dec. 20, 2021).

They are designed to mystify regulators and stymie any action that might jeopardize this source of revenue

Even when the broker-dealer negotiates a rate with the vendor that is lower than the NYSE-set maximum rate, the fund generally does not receive the lower rate. Instead, the vendor typically bills the fund for the maximum rate allowed under NYSE's fee schedule and then "remits" a portion of the fund's payment back to the broker-dealer, thereby splitting the profit. This practice must be prohibited.

The NYSE fee schedule allows broker-dealers to charge funds a premium *not* to mail fund materials through the US postal system. This "preference management fee" was originally designed to help broker-dealers cover the cost of switching their clients from paper to electronic delivery, back when email was a novel method of communication. Yet even though the work necessary to make the switch was done long ago— and even as email has become a routine part of modern life—broker-dealers still charge this premium, preventing fund investors from realizing the savings that electronic delivery should afford them.

Neither funds nor broker-dealers are required to deliver fund materials to shareholders invested through managed accounts where those shareholders have delegated proxy voting and investment discretion to the intermediary.[58] Despite that, it is common practice for the primary vendor (acting on behalf of its broker-dealer clients) to charge funds two different types of 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. These fees are charged with full knowledge that no shareholder will ever receive such fund materials because this delegation is a natural feature of the managed account, and not a "preference" that the shareholder is likely to change. For example, if a broker-dealer provides services to each of 1000 investors through a managed account, the vendor invoices the fund the NYSE schedule maximum fee of 25 cents per investor

[58] *See supra* note 56.

in the managed account (or a total of $250 dollars) for emailing a single summary prospectus to the broker-dealer. To be clear, *nothing* is delivered to any of the 1000 investors in our example.[59]

B. *Reforming the Processing Fee System for the Long Term*

NYSE has made it abundantly clear that it does not want to retain responsibility for overseeing the processing fee framework and has expressly rejected the notion that it is in the position to effectively consider the interests of brokers, funds, and other issuers when setting the fees.[60] FINRA, likewise, has asserted that it is in no better position to take on this responsibility. Given the SROs' reluctance and concerns about their ability to oversee the processing fee system, it is clear that the best option is for the Commission to step in and reform this system for the long-term benefit of investors. ICI recognizes that long-term changes may take time to adopt, which is why we urge the Commission to implement our near-term recommendations in the meantime (as outlined above).

The Commission has repeatedly suggested that "a long-term solution" to the processing fee system should "allow market forces rather than SRO rules to set rates."[61] Market participants also have long noted the "need for competition in the proxy distribution system and [for allowing issuers] to choose service providers."[62] It's no surprise that NYSE's Petition for Review emphasized commenters' desire for

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[59] ICI Compass Lexecon Letter at 4.

[60] Notably, in the Petition for Review, NYSE acknowledged that it lacks the necessary relationship with "several market participants involved in forwarding proxy materials," especially with mutual funds, and noted that it does not serve as a "convenient forum to bring together all market participants with relevant views on" the fee schedule. Petition for Review at 2, 3, 20.

[61] *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 Set Forth In Those Rules, Release No. 34-45644 (Mar. 25, 2002), 67 FR 15440, 15444 (Apr. 1, 2002) ("2002 Order"), *available at* https://www.govinfo.gov/content/pkg/FR-2002-04-01/pdf/02-7781.pdf; *see also* 2013 Approval Order at 68-70.

[62] *See* 2002 Order at 15442.

the Commission to "reform the current [processing fee system] in a way that both accounts for the views of all stakeholders and [fees for delivering regulatory materials] to market forces."[63]

Under the processing fee framework, funds have a much stronger incentive than broker-dealers to negotiate reasonable fees for fund investors. For example, the adviser to a fund has a fiduciary duty to act in the best interests of the fund and its shareholders, as do the fund's directors or trustees, with special responsibilities assigned to those who are independent. Competition in this market is unlikely to flourish and fees will not be tied to market forces under the current system. It is common sense to expect each broker-dealer to continue to outsource the responsibility to deliver fund materials to the primary vendor that rewards its loyalty by sharing the profits realized. Commission rules create this misalignment. We urge the Commission to correct this by amending Rules 14b-1 and 14b-2 under the Exchange Act so that funds may choose a vendor to deliver fund materials whether fund shares are held directly or through an intermediary.[64]

Questions have been raised as to whether eliminating the fee schedule will in fact result in greater competition and in lower processing fees. Funds' experience hiring vendors to deliver fund materials to direct-held accounts is compelling.[65] There are a number of vendors that compete for funds' business and the NYSE fee schedule does not govern the fees charged for direct-held accounts. If the SEC permits funds to select the vendor, from among those ready and willing to compete for the business of delivering materials on funds' behalf, we expect that funds would be able to negotiate lower prices for delivery than the maximum in the NYSE fee schedule, similar to the lower prices that they are able to secure today for

[63] Petition for Review at 3.

[64] In doing so, the Commission could make clear that broker-dealers must provide funds or their selected agent (*i.e.*, vendor), upon request, a data file with only the shareholder information necessary for delivering these materials. *See* ICI 2018 Letter at 19.

[65] *See id*. at 19-22.

their direct-held accounts. There are clear harms to funds and their investors under the current processing fee framework that the Commission must address.

If the Commission does not want to give funds the ability to negotiate more competitive processing fees, the Commission could itself replace NYSE's fee schedule with a new robust regulatory oversight framework—taking into account funds' disclosure delivery obligations, eliminating unreasonable billing practices, and engaging an independent third party to review the reasonableness of the fees at the outset and periodically thereafter. Either of the above approaches would be a significant improvement for fund investors, potentially saving them hundreds of millions of dollars a year.

CONCLUSION

For the foregoing reasons, the Commission should set aside the Disapproval Order and consider ICI's recommendations on how the Commission could repair the broken processing fee framework, both in the near term and the long term. The Division's reasoning for retaining the current fee schedule was misguided, and the Disapproval Order ultimately retains a processing fee system that creates perverse incentives, extracts excessive fees, and preserves practices that harm fund investors. It is high time for the Commission to take decisive action to fix this outdated system.

Dated: February 3, 2022
Washington, DC

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Susan Olson, General Counsel of the Investment Company Institute (ICI), hereby certify that on this 3rd day of February 2022, a copy of ICI's Statement in Opposition to the Disapproval of NYSE's Proposed Rule Change and Urging the Commission to Set Aside the Disapproval Order (File No. SR-NYSE-2020-96) was served on the following, via email at the email addresses indicated below:

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