



Securities Industry Association

120 Broadway, New York, NY 10271-0080, (212) 608-1500, Fax (212) 608-1604
1401 Eye Street, NW, Washington, DC 20005-2225, (202) 296-9410, Fax (202) 296-9775
info@sia.com, <http://www.sia.com>

December 6, 2002

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549 – 0609

**Re: Proposed Rules on Proxy Voting by Investment Advisers and
Registered Management Investment Companies (File No. S7-36-02)**

Dear Mr. Katz:

The Investment Adviser and Investment Company Committees of the Securities Industry Association (“SIA”)¹ are pleased to submit this response to the Commission’s investment adviser proxy voting rulemaking proposals contained in Release No. IA-2059, (“adviser proposal”), as well as the registered management investment company rulemaking proposals contained in Release Nos. 33-8131; 34-46518 and IC-25739 (“fund proposal”). The proposed rulemaking would, among other things, expand the scope of disclosure related to proxy voting policies and procedures and require advisers and mutual funds to maintain additional proxy-related records.

I. GENERAL OBSERVATIONS

The Committees support the instant proposals to the extent they will enhance adviser and fund disclosure with respect to their proxy voting policies and procedures, including, in particular, the

¹ The Securities Industry Association brings together the shared interests of more than 600 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of nearly 93 million investors directly and indirectly through corporate, thrift, and pension plans. In the year 2001, the industry generated \$198 billion in U.S. revenue and \$358 billion in global revenues. Securities firms employ approximately 750,000 individuals in the United States. (More information about SIA is available on its home page: <http://www.sia.com>.)

disclosure of potential conflicts of interest. This is information that investors may want to consider in the process of selecting investment advisers or appropriate mutual funds. We trust the "procedures" referenced in the proposal are intended to cover those relating to the voting decision, and not those relating to the mechanics of voting, which are of little interest to clients and shareholders, and would add unnecessary clutter to the disclosure document.

The Committees also fully support industry and regulatory efforts that are likely to have a meaningful impact on the governance of U.S. corporations. However, we believe that the Commission may have significantly overstated the influence advisers and fund managers can exert on corporate governance activities of corporations, and note that the vast majority of proxy votes relate to non-controversial matters. Furthermore, we question the overall effectiveness of attempts to impact corporate governance activities through regulation of third party behavior, as opposed to promoting corporate cultures that place a premium on the highest standards and ethics, and imposing strong regulatory penalties upon those who violate such standards.

According to the fund proposal release, mutual funds held approximately 19% of all publicly traded corporate equity securities as of the end of 2001,² and it appears that fund shareholders and investment advisory clients collectively hold nearly half of all domestic equity securities. While these numbers seem impressive in terms of the ability to impact corporate governance, such impact is based on the unsupported and unlikely premise--namely, that fund managers and investment advisers would vote collectively on any particular proxy proposal. Given the fact that there are hundreds of fund families, thousands of funds with a multitude of different investment objectives and thousands of advisers, a good number of whose investment authority may not in whole, or part, extend to the voting of proxies, it is hard to envision such disparate entities voting uniformly on any proxy proposal. Furthermore, the Commission has neither provided, nor requested, input regarding proxy-voting patterns that would support their conclusion that the instant proposals would substantially influence the outcome of corporate governance related proxy matters, or even that a current problem exists with the manner in which advisers and funds vote proxies.

We believe that given the possible recordkeeping burdens contained in the instant proposals, particularly the fund proposal, and potential unintended consequences, as discussed below, it is imperative that the above matters be considered before further Commission action is taken.

II. THE ADVISER PROPOSAL

SIA strongly believes that it is appropriate for investment advisers to vote proxies with respect to their clients holdings where such votes can add value to the clients' accounts. The majority of

² Release No. IC-25739, p.2

advisory clients view proxy voting by investment advisers as a natural extension of their role in portfolio securities selection. Indeed, SIA was a major proponent of SEC-approved amendments to SRO rules which enable proxy material to be forwarded directly to investment managers, rather than beneficial owners, in order to facilitate the advisers' ability to vote such proxies.³

As a general matter, SIA also believes that advisory clients should receive disclosure regarding the general policies and procedures an adviser has adopted with respect to voting proxies, and that advisers should be able to provide such disclosure through either the advisory contract, Form ADV, Part 2 or other reasonable means. We are concerned however, that the scope of the disclosures contemplated in the rule proposal create an inference--unintended or otherwise--that proxy voting policies and procedures need to be different where a potential conflict exists. We believe that this may distort the proxy voting process by causing the adviser to vote in a manner designed to avoid even the appearance of conflict, rather than in accordance with what it believes to be in the best interest of the client. Alternatively, advisers may choose to address this by retaining disinterested third parties at additional cost, referring voting decisions back to the client or possibly declining to exercise voting authority at all in non-ERISA contexts. All of these alternatives clearly run counter to the expectation of the client in retaining the services and expertise of an investment adviser. An even more problematic result would be that advisers may be discouraged from purchasing securities for client accounts to avoid even the appearance of conflict or controversy, although such securities may be otherwise entirely consistent with the investment objectives of their clients.

More fundamentally, it is extremely difficult to identify what conflicts would be material in the context of a future proxy proposal, much less state prospectively how they would, or should, be resolved. Anything other than a general written statement of policies and procedures is likely to unduly restrict the ability of advisers to consistently address proxy voting matters in the manner that serves the best interests of clients, without exposing them to second-guessing and significant litigation risk.

We would also note that while the proposed recordkeeping amendments under Rule 204-2 of the Investment Advisers Act of 1940 are somewhat less extensive than those contained in the fund proposal, they are nonetheless extremely burdensome to comply with in the context of certain types of advisory programs. In particular, numerous firms offer advisory programs managed by individual dually registered RR/IA's. In larger firms, hundreds, or even thousands of such dual registrants, manage advisory accounts for one or more investors. The ability under such circumstances to track proxy statements received, records of votes cast, records of all communications received and internal documents created related to the voting decision, would be a daunting and likely overwhelming task.

³ SEC Release No. IA-2059.

Similarly, in advisory programs tailored to smaller investors, the cost of detailing how a particular client's proxies were voted may far exceed any realistic benefit. For these types of programs, the final rule should provide the adviser with the flexibility to report to clients how the adviser voted with respect to particular companies, without the need to break it down for each client's particular holdings.

III. THE FUND PROPOSAL

Many of the concerns expressed with respect to the adviser proposal apply equally to the fund proposal, including our concerns regarding problematic efforts to impact corporate governance activities through regulation of third parties. In this regard we would note that funds are subject to regulatory and tax requirements which effectively prevent them from owning significant quantities of any particular corporate issuer's securities.⁴

We question the appropriateness of imposing extensive proxy voting disclosure and recordkeeping requirements on any particular class of investors, especially where the vast majority of proxy votes are unlikely to involve corporate governance matters or situations where conflicts of interest may exist. Notwithstanding the Commission's estimates at the costs of compliance we believe the actual burden and expense far exceeds the Commission's estimate

We also question why it would be necessary for a fund to file its complete proxy voting record periodically with the Commission, or for it to be made publicly available via its own or the Commission's website. The process of transposing this information onto Form N-CSR would be extremely burdensome and would result in the Commission collectively receiving tens of millions of pieces of proxy data on a periodic basis. The sheer volume of data (much of it of marginal interest) would seem to preclude any possibility for effective regulatory oversight or investor benefit. We believe that, at most, it should be sufficient for the fund to maintain proxy voting records, and that this information be made available for inspection during regular Commission examinations or upon request.⁵

Finally, while we support disclosure of proxy voting policies and procedures under both proposals, we question the viability of requiring a fund to disclose in its annual or semi-annual reports any proxy votes that are "inconsistent" with its voting policies and procedures. Firstly, given the wide diversity of subjects which might be addressed in proxy votes, the unpredictability of future economic and market conditions or the specific future circumstances of the issuer, policies and procedures would

⁴ See e.g., Investment Company Act of 1940, Section 5(b)(1); Internal Revenue Code of 1986, Section 851(b)(3).

⁵ We note that the rulemaking proposal delineates 9 categories of information that would have to be disclosed on proposed Form N-CSR with respect to each proxy matter on which a fund is entitled to vote. If a typical fund holds about 100 securities positions, and each issuer's proxy contained 5 voting proposals, the fund would need to file 4,500 items of information on Form N-CSR (100x5x9=4500), much of which would have little, if anything to do with corporate governance matters. This is just one example of the way in which the costs of complying with the proposal can rapidly mount.

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have to be flexibly drawn to facilitate the fund's continuing ability to vote in the best interests of shareholders, without being subject to a heightened litigation risk. Thus, the circumstances where a vote is inconsistent with any reasonable policies or procedures are likely to be rare. Secondly, even assuming a fund can clearly determine that a vote it believed to be in the best interest of shareholders would be inconsistent with its stated policies and procedures, it may be reluctant to vote its convictions, out of a desire to avoid the negative and unwarranted connotation attached to an "inconsistent" vote.

We also believe that in determining the requirements and costs of any final rule, the Commission should carefully consider how sub-advised investment companies would be treated. The complexities and costs noted above would likely be increased exponentially for these types of funds. For example, a fund with 10 sub-advisers might need to set forth 10 different proxy voting policies, and collate data from 10 different sources. Any possible benefits to shareholders could pale in comparison to the burdens.

IV. CONCLUSION

While the Committees' generally support reasonable disclosure and recordkeeping requirements with respect to proxy voting by advisers and funds, we do so because advisory clients and fund shareholders have a right to consider such information as part of the process of selecting investment advisers or funds. However, we reject the notion that these proposals, particularly the more burdensome disclosure and recordkeeping requirements, should be adopted because they would have a significant impact on corporate governance. We respectfully suggest that the Commission has not obtained sufficient information to support that position, and we believe the information that is available suggests a contrary conclusion.

The Committees' appreciate the opportunity to comment, and would welcome the opportunity to discuss the instant proposals further with the staff. Any question regarding this letter should be directed to Michael D. Udoff of SIA staff at (212) 618-0509 or mudoff@sia.com.

Sincerely,

Paul S. Gottlieb
Chairman
SIA Investment Adviser Committee

Gerald T. Lins
Chairman
SIA Investment Company Committee

cc: The Honorable Harvey L. Pitt
The Honorable Cynthia A. Glassman

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The Honorable Harvey J. Goldschmid
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
Paul F. Roye, Esq.
Director, Division of Investment Management