STATEMENT OF PAUL SCHOTT STEVENS

PRESIDENT AND CEO

INVESTMENT COMPANY INSTITUTE

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

ON

"SEC PROXY ACCESS PROPOSALS: IMPLICATIONS FOR INVESTORS"

SEPTEMBER 27, 2007

Executive Summary

- ICI generally supports the SEC's proposal to afford certain shareholders direct access to a company's proxy materials for director-related bylaw amendments.

- As major, long-term investors in securities of public companies, and as issuers with their own shareholders and boards of directors, investment companies have a valuable perspective to offer on the topic shareholder access and the need to appropriately balance the interests of shareholders with those of company management.

- The SEC's proposal would represent a significant change in longstanding rules and practices. ICI agrees that long-term shareholders with a significant stake in a company have a legitimate interest in having a voice in the company's corporate governance. The ability to submit bylaw amendments concerning director nomination procedures could be an effective additional tool for use by investment companies and others to enhance shareholder value.

- At the same time, the privilege of proxy access should not be granted lightly. The federal securities laws should not facilitate efforts to use a company's proxy machinery – at company expense – to advance parochial or short-term interests not shared by the company's other shareholders.

- Limits on the ability to use company resources to propose changes to a company's governing documents are critically important to assure that the interests of shareholder proponents are aligned with those of the company's other shareholders. ICI strongly supports the SEC's proposal to limit the privilege of proxy access to shareholders who do not acquire or hold the company's securities for the purpose of changing or influencing control of the company.

- ICI also supports requiring shareholder proponents to demonstrate that they are long-term stakeholders with a significant ownership interest and will strongly encourage the SEC to consider instituting thresholds greater than the five percent ownership and one-year holding period proposed.

- Disclosure that shareholder proponents and shareholders that nominate director candidates are required to provide will be important to allow a company's other shareholders to make informed voting decisions. To bring additional discipline to the shareholder proposal process, the SEC's rules should hold shareholder proponents and nominating shareholders – and not companies – responsible for the information these shareholders provide.

- ICI supports the SEC's proposal to facilitate greater interaction among shareholders and between shareholders and companies through the use of electronic shareholder forums.

I. INTRODUCTION

My name is Paul Schott Stevens. I am President and CEO of the Investment Company Institute, the national association of U.S. investment companies. ICI members include 8,803 open-end investment companies (mutual funds), 671 closed-end investment companies, 457 exchange-traded funds (ETFs), and 4 sponsors of unit investment trusts. As of June 30, 2007, our members had total assets of nearly $12 trillion.

In addition to their role as the investment vehicle of choice for millions of Americans, registered investment companies are major investors in securities and participants in the marketplace. At the end of 2006, investment companies held approximately 25 percent of the outstanding stock of U.S. companies.[1]

Based on their dual roles as major investors in securities of public companies acting as fiduciaries on behalf of millions of individual investors, and issuers of securities with their own shareholders and boards of directors, investment companies offer a valuable perspective on the subject matter of today's hearing. I greatly appreciate the opportunity to appear before the Committee to share the Institute's views on shareholder access to company proxy materials and related issues.

[1] Investment Company Institute, 2007 Investment Company Fact Book, at 10-11.

II. SHAREHOLDER ACCESS TO COMPANY PROXY MATERIALS

The topic of shareholder access to company proxy materials historically has been a polarizing one, seemingly pitting shareholders' rights against corporate management's interests. Unlike a proxy contest, in which the contesting party pays the costs of soliciting proxies, providing access to the company's own proxy imposes on the company and all shareholders the costs of a cause being advanced by a minority. Given these considerations, the question becomes when – if ever – is it appropriate to grant this privilege?

The Securities and Exchange Commission has proposed rule amendments that would enable shareholders to include in company proxy materials their proposals for bylaw amendments regarding the procedures for nominating candidates for the board of directors.[2] If the company's shareholders at large vote to approve the bylaw amendments, then shareholders could nominate directors on a subsequent company proxy, to the extent the new procedures so provide.[3] If adopted, the SEC's proposal would represent a significant change in longstanding rules and practices. Currently, companies are permitted to exclude shareholder proposals relating to a director election.

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[2] SEC Release Nos. 34-56160; IC-27913 (July 27, 2007), 72 FR 43466 (August 3, 2007). The Institute expects to file a comment letter on the proposal with the SEC by the October 2, 2007 comment deadline. The SEC also issued a contrary rule proposal that would deny such access. SEC Release Nos. 34-56161; IC-27914 (July 27, 2007), 72 FR 43488 (August 3, 2007). For the reasons expressed in this testimony, the Institute does not support that proposal.

[3] As discussed below, the SEC's proposal would require shareholders who nominate directors to provide the disclosure that is currently required in the case of a proxy contest.

Unlike those stakeholders who may fall clearly on one side of the proxy access debate or the other, Institute members have one foot in each camp. Funds are significant shareholders of public companies. They also are public companies with their own shareholders and boards of directors. They fully appreciate the importance of quality governance. They also are conscious of the need to avoid unreasonable interference with the responsibility of a company's directors and officers to manage the company. By attempting to balance these perspectives, our views are likely to draw criticism from both sides. But while our vantage point may make us a target for critics, it gives us a special appreciation for the need to tread cautiously to achieve an appropriate balance in addressing this matter. And in determining how to strike that balance, we have asked ourselves, what is the right answer for the fund shareholders our members serve and other long-term investors?

A. The Privilege of Proxy Access

The Institute believes that the interests of investors will be served by allowing shareholders, under certain circumstances, to have their proposals for bylaw amendments concerning procedures for nominating directors included in a company's proxy materials. We agree that long-term shareholders with a significant stake in a company have a legitimate interest in having a voice in the company's corporate governance.

Institute members serve as stewards for the interests of fund shareholders and use a variety of methods to seek to enhance shareholder value. These methods include, among others, voting proxies for the securities funds hold in a manner consistent with the funds' objectives and engaging in ongoing dialogue with management of the companies in which they invest. To have in reserve the ability to submit bylaw amendments concerning director nomination procedures could prove to be an effective additional tool for enhancing shareholder value.

At the same time, providing access to a company's proxy as the SEC has proposed would represent a dramatic change in existing rules with significant implications for the relationship between public companies and their shareholders. The privilege of proxy access should not be granted lightly. Great care must be taken to ensure that the federal securities laws do not facilitate efforts to use a company's proxy machinery to advance parochial or short-term interests not shared by the company's other shareholders. The SEC should not make it easier, for example, for short-term opportunists or minority shareholders with their own agendas to seek changes – at company expense – that do not redound to the benefit of the company's long-term shareholders. Instead, the regulatory scheme should be crafted to afford access to a company's proxy only when the interests of shareholder proponents are demonstrably aligned with those of long-term shareholders.

Our recommendations for achieving these objectives are discussed below.

B. Eligibility Criteria

The SEC's proposal would require a shareholder (or group of shareholders) proposing bylaw amendments concerning director nominations ("shareholder proponents") to meet specified eligibility criteria. The bylaw amendments would have to be submitted by shareholder proponents who:

(i) did not acquire or hold the securities for the purpose of changing or influencing control of the company;

(ii) have continuously held more than five percent of the company's securities entitled to be voted on the proposal for at least one year by the date the shareholder submits the proposal; and

(iii) make certain disclosures, including its background and relationships with the company.

Appropriate limits such as these on the ability to use company resources to propose changes to a company's governing documents are critically important. Such limits should be designed to assure that long-term shareholders do not bear the costs of advancing the narrow or short-term interests of minority shareholders. Including shareholder proposals in company proxy materials involves not only out-of-pocket costs, but also opportunity costs for long-term shareholders if the ultimate effect is to change the fundamental character of the company or its policies in a manner inconsistent with those shareholders' original investment intent. Eligibility criteria thus should avoid opening the floodgates to those who might seek to accumulate positions in companies only to "smash and grab" short-term profits or other benefits at the expense of such companies and their other shareholders.

1. Intent to Change or Influence Control

The SEC has proposed that, to be eligible to submit a shareholder proposal, shareholder proponents must be eligible to file (and must file) a statement of beneficial ownership on Schedule 13G. To be eligible to file on Schedule 13G, a shareholder may not acquire or hold the securities for the purpose of changing or influencing control of the company. In our view, this criterion goes to the heart of the proposal and the Institute strongly supports it. Proponents seeking to change or influence control of the company should not be granted license to do so at the company's expense. They should be required to follow the regulatory framework already in place for proxy contests and bear the related costs. The Institute believes that this factor will significantly curb abusive use of a company's proxy machinery, providing necessary protections for long-term shareholders and reducing management distractions.

2. Ownership Threshold

Under the SEC's proposal, shareholder proponents must have continuously and beneficially held more than five percent of the company's securities entitled to be voted on the proposal for at least one year by the date the proposal is submitted. For the reasons outlined above, it is entirely appropriate to limit the availability of this proposed avenue for advocating change to a company's governing documents to shareholders with a significant ownership interest.

Defining the appropriate ownership threshold for the proposal presents a classically difficult line-drawing exercise of the type that legislators and regulators engage in on a regular basis. There is no "correct" level of ownership that should entitle shareholders to the privilege of proxy access. Some will claim that the five percent level proposed by the SEC is much too high and will serve as a significant impediment to shareholder participation. Others will argue that five percent is much too low and will subject companies to unwarranted and expensive distractions and disruptive activity.

It is our sense that, given the significant change in approach that the SEC's proposal represents, the SEC would be well-advised to proceed cautiously by starting with a relatively high minimum ownership threshold. We note that it is not uncommon for one institutional investor to hold five percent or more of a company.[4] Under the proposal, such an investor potentially could single-handedly get proposed bylaw amendments included in a company's proxy materials. A five percent threshold to gain access to a company's proxy statement could work to the advantage of opportunists whose activities and motives may not be transparent to other shareholders and the marketplace and who have no fiduciary obligation to act in the interests of other shareholders.

The Institute therefore will strongly encourage the SEC to consider instituting an ownership threshold higher than five percent. To inform its decision, the SEC should study holdings information to determine, for example, the frequency of large holdings of companies and the identity of the holders.

[4] For example, some Institute members report that they often have holdings of five percent or more of companies in which they invest. In far fewer instances do they hold 10 percent or more of a portfolio company. Based on data from © CRSP University of Chicago and the Institute, we were able to examine portfolio holdings of 2,409 domestic equity mutual funds for 276 complexes as of the fourth quarter of 2006. Based on this analysis, we estimate that 87 mutual fund complexes had a total of 1,887 holdings of 5 percent or more of the U.S. companies in which they invest. At a 10 percent threshold, we estimate that 33 mutual fund complexes had a total of 314 holdings that met or exceeded the threshold.

A higher threshold likely would mean that in most cases, a single shareholder, including an investment company or other institutional investor, would need to collaborate with one or more other shareholders to reach the applicable threshold. A higher threshold thus would encourage shareholders to come together to effect change, and would better assure that the company's proxy machinery would be used to advance the common interests of many shareholders in addressing legitimate concerns about the company. And it would help guard against efforts by one or a few shareholders to use a company's proxy to achieve their own narrow ends.

We will also strongly recommend that the SEC make explicit that shareholder proponents who borrow stock of an issuer may not count those shares toward meeting the ownership threshold or the holding period (discussed below). Beneficial ownership of the securities should be required to assure that the proponents' interests truly are aligned with those of other shareholders.

3. Holding Period

Shareholder proponents should be required to demonstrate that they are long-term stakeholders. Most investment companies are long-term holders of the securities in which they invest.[5] Indeed, the assets of registered investment companies whose investment strategies are index-based have been growing. By year-end 2006, assets in registered ETFs and index mutual funds reached a little more than $1.1 trillion, and accounted for 10 percent of the total assets managed by all registered investment

[5] Based on the Institute's analysis, we estimate that 233 fund complexes held shares of 3,763 U.S. companies for at least two years over the period from the fourth quarter of 2004 to the fourth quarter of 2006.

companies.[6] These funds by definition are committed to holding the securities in the relevant index, as their disclosed investment policies indicate.

The one-year period proposed by the SEC strikes us as the minimum acceptable threshold and we expect to recommend to the SEC that it consider requiring a longer holding period. A longer holding period, such as two years, would provide greater assurance that shareholder proponents are have been committed to the long-term mission of the company, rather than seeking the opportunity for personal gain and quick profits at the company's and other shareholders' expense. As with the ownership threshold, there is no "right" answer. The SEC should examine holding periods along with ownership levels to arrive at well-reasoned criteria that will encourage would-be shareholder proponents to work together to achieve goals that benefit all shareholders.[7]

C. Disclosure Requirements

The disclosure that shareholder proponents and shareholders that nominate director candidates ("nominating shareholders") would be required to provide is another key consideration

[6] Over the past decade, assets in these indexed products have increased more than tenfold – with much of the growth occurring in funds that track broad market indexes. ETFs and index mutual funds that track large-blend domestic equity indexes, such as the S&P 500, now manage 40 percent of all assets invested in mutual funds and ETFs that focus on large-blend domestic stocks. Investment Company Institute, 2007 Investment Company Fact Book, at 35.

[7] Based on the Institute's analysis, we estimate that 56 mutual fund complexes had 966 holdings that were 5 percent or more both in the fourth quarter of 2005 and in the fourth quarter of 2006. At a 10 percent threshold and one-year holding period requirement, we estimate that 17 complexes had 114 holdings of U.S. companies. For a two-year holding period (2004-2006) and 5 percent threshold, we estimate that 37 complexes had 552 holdings. For a two-year holding period and 10 percent threshold, we estimate that 10 complexes had 45 holdings. These figures demonstrate the effect of increasing the thresholds on the need for shareholders to work in a collaborative manner to obtain access to a company's proxy – a laudable goad that will protect the interests of long-term shareholders.

related to proxy access. For example, under the SEC's proposal, shareholder proponents would have to provide disclosure about their background, intentions, and course of dealing with the company. The Institute agrees with the SEC's assessment that disclosure plays an especially important role "when individual shareholders or groups or shareholders, who do not owe a fiduciary duty to the company or to other shareholders, use company assets and resources to propose changes in the company's governing documents."[8] The information the SEC proposes to require will be relevant to shareholders when they are asked to consider a shareholder-proposed bylaw amendment setting forth procedures for director nominations and to the marketplace at large.

Similarly, we support the SEC's proposal to require nominating shareholders to provide the same disclosure that would otherwise be required under the rules applicable to proxy contests.[9] This information is necessary to allow a company's other shareholders to make informed voting decisions. Importantly, the SEC's proposal would hold nominating shareholders liable for any materially false or misleading statements in the disclosure provided to the company and included by the company in its

[8] 72 FR at 43471.

[9] *See* Items 4(b) and 5(b) of Schedule 14A under the Securities Exchange Act of 1934. Disclosures required in proxy contests include, among other things: who is making the solicitation and by what means; the costs of the solicitation and who will bear them; any substantial interest of each participant in the solicitation; the name, address, and principal occupation or business of any participant; the amount of securities of the company owned by each participant and its associates; information about purchases and sales of the securities by such persons within the past two years; whether a participant is a party to any contract, arrangements or understandings with any person with respect to the company's securities; certain related party transactions between the participant or its associates and the company; any arrangement or understanding with respect to future employment or future transactions with the company or its affiliates. A "participant" for this purpose is (i) any person who solicits proxies, (ii) any director nominee for whose election proxies are being solicited, and (iii) any committee or group, any member of a committee or group, and other persons involved in specified ways in the financing of the solicitation. Additional information is required about shareholder nominees for director, including: any arrangement or understanding with a nominating shareholder pursuant to which the nominee was selected; the nominee's business experience; other directorships in Exchange Act reporting companies; involvement in certain legal proceedings; transactions between the nominee and the company; and whether the nominee complies with independence requirements. *See* Item 7 of Schedule 14A.

proxy materials. It also would make clear that the company is not responsible for that disclosure. The Institute strongly supports holding nominating shareholders, and not companies, accountable for the accuracy of the disclosure these shareholders provide. This will bring additional discipline to the shareholder proposal process.

For the same reason, similar treatment should apply to information provided by shareholder proponents. Shareholders contemplating submitting bylaw proposals need to understand that they will be held liable for providing materially false or misleading information, whether in Schedule 13G filings, in a bylaw proposal included in a company's proxy statement, or in company proxy disclosure based on information provided by shareholder proponents. It is critically important that companies be shielded from liability for disclosure that relies on information provided by shareholder proponents.

III. ELECTRONIC SHAREHOLDER FORUMS

The SEC took steps 15 years ago to facilitate communications among institutional shareholders.[10] More recently, many have observed the tremendous potential of the Internet and other technological developments to expand and enhance opportunities for communication among *all* shareholders as well as between shareholders and companies. The SEC recognizes that the current proxy rules may create unnecessary impediments to fully realizing this potential. To facilitate greater interaction among shareholders and between shareholders and companies through electronic media,

[10] *See* Rule 14a-2(b)(1) under the Securities Exchange Act of 1934.

the SEC has proposed a new rule that would clarify that both companies and shareholders may establish and maintain electronic shareholder forums.

The Institute has consistently supported SEC efforts to facilitate greater use of electronic media to better serve investors,[11] and we support the electronic shareholder forum proposal. Electronic forums are an innovative and relatively inexpensive way to foster communications among shareholders and between shareholders and companies. In its proposal, the SEC wisely declined to devise an approved regulatory version of an electronic shareholder forum. We applaud the decision to encourage individuals and entities to use creativity in designing and utilizing this communication mechanism. The SEC's approach also provides necessary flexibility to take advantage of future technological advances.

Another important aspect of the SEC's proposal is the clarification that neither a company nor a shareholder would be liable for independent statements made by others on its electronic forum. This protection is vital if the SEC wishes to encourage the establishment and use of shareholder forums.

[11] *See, e.g.,* Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated March 14, 2007 (regarding extension of interactive data voluntary reporting program on the EDGAR system to include mutual fund risk/return summary information); Letter from Elizabeth Krentzman, General Counsel, Investment Company Institute, to Nancy M. Morris, Secretary, U.S. Securities and Exchange Commission, dated February 13, 2006 (regarding Internet availability of proxy materials).

IV. PROXY VOTE DISCLOSURE

The SEC's proposals discussed above seek to expand the means through which shareholders can have a voice in the governance of companies whose shares they own and communicate with each other and with management. These mechanisms would supplement the existing opportunities that shareholders have to express their views through the current proxy system.

Like other shareholders of public companies, mutual funds and other registered investment companies are entitled to vote proxies for the securities they hold. Funds, their investment advisers and directors take their responsibilities with respect to proxy voting very seriously. Unlike any other shareholder, however, funds are required to publicly disclose each and every proxy vote they cast. By singling out funds, this requirement has created unintended consequences for fund firms. Among other things, this regulatory disparity means that only fund firms are subjected to scrutiny and criticism for the manner in which they voted, thereby uniquely politicizing fund portfolio management.

To the extent that disclosure of proxy voting records is considered to achieve important public policy purposes, these requirements should be applied to all institutional investors. The Institute appreciates Chairman Frank's expression of interest in having the Committee consider this issue.[12] We

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[12] *See* Siobhan Hughes, *Rep. Frank Plans Hearing on Disclosure of Proxy Votes,* Dow Jones News Service, March 22, 2007.

would welcome the opportunity to participate and stand ready to assist the Committee and its staff in any way possible.

V. CONCLUSION

On behalf of the Institute's members and the millions of individual shareholders they serve, I very much appreciate the opportunity to share the Institute's views with you today. We look forward to working with the SEC and the Committee on these important issues.