

information to use in selecting funds. On a related point, we anticipate that over time, commercial third-party information providers will offer services that will enable investors to better analyze proxy voting by funds. These developments will further facilitate the benefits to fund investors from proxy vote disclosure.

Second, in some situations the interests of a fund's shareholders may conflict with those of its investment adviser with respect to proxy voting. This may occur, for example, when a fund's adviser also manages or seeks to manage the retirement plan assets of a company whose securities are held by the fund. In these situations, a fund's adviser may have an incentive to support management recommendations to further its business interests. The amendments require funds to disclose how they address such conflicts of interest in determining how to vote their proxies. This disclosure requirement may benefit fund shareholders by deterring voting decisions that are motivated by considerations of the interests of the fund's adviser rather than the interests of fund shareholders. Further, the increased transparency resulting from proxy voting disclosure may increase investors' confidence that their fund managers are voting proxies in accordance with their fiduciary duties.

A third significant benefit of the amendments comes from providing stronger incentives to fund managers to vote their proxies conscientiously. The amendments could increase the incentives for fund managers to vote their proxies carefully, and thereby improve corporate performance and enhance shareholder value. The improved corporate performance that could result from better decisionmaking in corporate governance matters may benefit fund investors. In addition, other equity holders may benefit from the improvement to corporate governance that results from more conscientious proxy voting by fund managers. We note that assets held in equity funds account for approximately 18% of the \$11 trillion market capitalization of all publicly traded U.S. corporations, and therefore funds exercise a considerable amount of influence in proxy votes affecting the value of these corporations.<sup>70</sup>

The benefits to the economy that will result from improved corporate governance are difficult to measure. While measuring the effects of such a rule involves a high degree of uncertainty, the scale of the aggregate

portfolio holdings involved suggests that they may be substantial.<sup>71</sup>

A number of commenters addressed the benefits of the proposals identified in the Proposing Release. Most commenters who addressed the costs and benefits of our proposals concurred with our assessment of the benefits of the proposed requirements to disclose the policies and procedures that funds use to determine how to vote proxies relating to securities held in their portfolios.

Our proposals to require disclosure of the actual votes cast by funds generated divergent views as to the possible benefits of this disclosure. Many commenters, including individual investors, labor unions, trustees of pension and retirement plans, and funds that currently make their proxy voting records available to their shareholders agreed with our assessment of the benefits of this disclosure, and argued that these benefits would be substantial. These commenters stated that investors would benefit from the increased transparency resulting from disclosure of proxy voting records, by allowing investors to consider a fund's proxy voting record when making an investment decision.<sup>72</sup> In addition, commenters argued that disclosure of proxy votes cast would have beneficial effects across the entire U.S. economy, by encouraging better decisionmaking in corporate governance matters, which would enhance shareholder value of the issuers of portfolio securities and, in turn, benefit both investors in the fund and other investors in these issuers.

Many other commenters, however, argued that the disclosure of proxy votes cast would not benefit fund investors. These commenters, who consisted primarily of funds, investment advisers, and members of boards of directors of funds, argued that the funds with which they are associated have received virtually no requests from their shareholders for proxy voting information.<sup>73</sup> They also argued that investors who care about proxy vote disclosure can decide to invest in those funds that choose to disclose their votes.

The arguments of these commenters do not address two important considerations, however. First, investors consider many factors besides proxy voting histories when choosing their investment managers. If other factors—

for example, fund performance—are more important to them than proxy voting, competitive pressures alone may cause few funds to reveal their proxy votes. The fact that market pressure has not forced many funds to reveal their votes merely suggests that investors do not value transparency of proxy votes as much as they value other factors. That does not mean that investors do not value transparency of proxy votes. In addition, the availability of proxy voting information may increase shareholder interest in the future. Second, these arguments do not consider the external benefits that all fund investors may obtain if, as discussed above, disclosure increases the incentives for fund managers to vote their proxies more carefully, and thereby improve corporate performance and enhance shareholder value.

Commenters who objected to the proposed disclosure requirement also questioned whether disclosure of proxy voting records would benefit investors by discouraging voting motivated by conflicts of interest, and noted that the Proposing Release did not provide any evidence of any fund failing to vote its proxies in its shareholders' best interests due to a conflict of interest. However, as noted above, funds may have strong incentives to vote in a certain way when, for example, a fund's adviser also manages or seeks to manage the retirement plan assets of a company whose securities are held by the fund. It may be difficult to prove that a particular vote in such a situation was motivated by a conflict of interest, and therefore disclosure may be the most effective means of deterring these conflicts.

In addition, commenters objected to the argument that proxy voting disclosure would result in benefits to all investors by encouraging funds to be more engaged in corporate governance of issuers held in their portfolios. The commenters asserted that funds were already sufficiently engaged in corporate governance issues, and that requiring disclosure of proxy votes by funds, but not other institutional investors, would unfairly single out one class of investors and force them to bear the burdens of the Commission's broader objectives with respect to the improvement of corporate governance.<sup>74</sup>

We recognize that while the costs of the disclosure requirements will be borne by funds, the benefits of improved corporate governance resulting from the disclosure will accrue to all investors. We note, however, that investors in a fund may benefit from any improved

<sup>71</sup> *Id.*

<sup>72</sup> See, e.g., Letter of Mercer Bullard, Fund Democracy, LLC (Oct. 21, 2002).

<sup>73</sup> See, e.g., ICI Letter, *supra* note 55, at 9; Letter of Robert D. Neary, Chairman of the Board, Armada Funds, at 2 (Dec. 4, 2002); Letter of Domenick Pugliese, Senior Vice President, Alliance Capital Management L.P. (Dec. 5, 2002).

<sup>74</sup> See, e.g., ICI Letter, *supra* note 55, at 12.

<sup>70</sup> See Flow of Funds Accounts, *supra* note 7.