

contrast, a fund industry trade group estimated, based on a survey of eight fund complexes conducted on its behalf by a third-party, that proxy voting record disclosure would cost approximately \$3,380 per fund in start-up costs, and \$5,530 per year in ongoing costs.<sup>95</sup>

We also note, as discussed above, that we have modified our proposals in three significant ways, in part in response to concerns expressed about costs by commenters. First, the amendments will require disclosure of proxy votes cast in annual reports on Form N-PX, rather than semi-annually on Form N-CSR. Second, we are not adopting the proposed requirement that funds disclose in their annual and semi-annual reports to shareholders votes that were inconsistent with their proxy voting policies and procedures. Third, rather than requiring funds to send their proxy voting records without charge and upon request, we are permitting them to choose to make their records available either upon request or by making available an electronic version on or through their Web sites.

The rules may also impose potential indirect costs on fund managers. Several commenters identified certain indirect costs that they argued were not addressed by the cost-benefit analysis in the Proposing Release. First, commenters argued that depriving funds of confidential voting would subject them to possible retaliatory actions by corporate management of the issuers of portfolio securities, such as restricting access by portfolio managers to corporate personnel.<sup>96</sup> These costs are difficult to quantify. Further, these commenters did not provide any evidence that this retaliatory action has occurred or might occur as a result of proxy vote disclosure. We also note that while it is possible that corporations could retaliate against fund managers if they knew that those fund managers had voted against them in the past, it is also possible that corporations could react by trying to work harder to develop cooperative relationships with fund managers. One additional advantage of the amendments is that they will permit fund managers to demonstrate credibly to management of a portfolio company that they have been willing to vote against the recommendations of corporate management in other cases.

Second, several commenters, including funds, claimed that required

disclosure of proxy voting records would politicize the process of proxy voting and thereby impose costs on funds in order to address orchestrated campaigns in the media and elsewhere by special interest groups, which would detract from a fund's ability to concentrate on the management of its portfolio.<sup>97</sup> These commenters did not provide any estimates of the magnitude of these costs, however. Some commenters argued that proxy vote disclosure might lead to certain groups threatening to encourage their members and others to withdraw their investments from a fund complex unless the funds' adviser voted in a certain way.<sup>98</sup> To the extent that this possibility is real, and that fund managers may be pressured by large or influential shareholders to vote as directed, making voting policies and procedures available to investors will mitigate this influence to a large degree. Because of the disclosure requirements we are adopting, shareholders will be able to evaluate how closely fund managers follow their stated proxy voting policies, and to react adversely to fund managers who vote inconsistently with these policies.

#### **VI. Consideration of Burden on Competition; Promotion of Efficiency, Competition, and Capital Formation**

Section 23(a)(2) of the Exchange Act requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. Section 23(a)(2) also prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>99</sup> In addition, Section 2(c) of the Investment Company Act, Section 2(b) of the Securities Act, and Section 3(f) of the Exchange Act require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>100</sup>

<sup>97</sup> See, e.g., Letter of Eric D. Roiter, Senior Vice President and General Counsel, Fidelity Management & Research Co., at 6-7 (Dec. 6, 2002); Letter of Philip L. Kirstein, General Counsel, Merrill Lynch Investment Managers, L.P., at 7 (Dec. 6, 2002).

<sup>98</sup> See, e.g., Jonathan S. Bowater, Paul S. Lowengrub, and James C. Miller III, *The SEC's Proposal to Require Mutual Funds to Publish Proxy Votes*, at 23, *attachment to Letter of Craig Tyle*, General Counsel, Investment Company Institute (Jan. 16, 2003).

<sup>99</sup> 15 U.S.C. 78w(a)(2).

<sup>100</sup> 15 U.S.C. 77(b), 78c(f), and 80a-2(c).

The Commission has considered these factors.

The amendments requiring disclosure of funds' proxy voting policies and procedures and actual proxy voting records are intended to provide greater transparency for fund shareholders regarding the management of their investments in funds. The amendments may improve efficiency. The enhanced disclosure requirements will provide shareholders with greater access to information regarding the proxy voting policies and decisions of the funds in which they invest, which should promote more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. The amendments may also improve competition, as enhanced disclosure may prompt funds to seek to differentiate themselves based on their proxy voting policies and practices. Finally, the effects of the amendments on capital formation are unclear. Although, as noted above, we believe that the amendments will benefit investors, the magnitude of the effect of the amendments on efficiency, competition, and capital formation is difficult to quantify.

In the Proposing Release, we requested comment on whether the proposed amendments would promote efficiency, competition, and capital formation, or, conversely, would impose a burden on competition. The Commission received several letters addressing the effect of the proposed amendments on efficiency, competition, and capital formation. A number of commenters expressed concern that the required disclosure, particularly the requirements that funds disclose their proxy votes cast and any votes that are inconsistent with their proxy voting policies, may have adverse effects on competition and capital formation among funds. Commenters argued that the amendments would disadvantage funds relative to other institutional investors such as banks and pension funds, because funds would be the only class of investors not allowed to vote confidentially. Further, the commenters argued, depriving funds of confidential voting would subject them to possible retaliatory actions by corporate management of the issuers of portfolio securities, such as restricting access by portfolio managers to corporate personnel. Commenters also argued that requiring funds to disclose their proxy votes would subject them to orchestrated campaigns in the media and elsewhere by special interest groups with social or political agendas different from those of fund shareholders, which would detract from a fund's ability to

funds after the first fund. Thus, a fund complex with 20 funds would pay \$34,000 (\$3,000 + \$12,000 + (19 × \$1,000)), or \$1,700 per fund.

<sup>95</sup> ICI Letter, *supra* note 55, at 14-15.

<sup>96</sup> See, e.g., Letter of Richard Mason, General Counsel, Mosaic Funds (Nov. 27, 2002).