

day of its most recent fiscal year.<sup>52</sup> Of the 6,203 advisers the Commission estimates will be affected by the new rule, the FRFA estimates that 138 are likely to be small entities.

As discussed in the FRFA, the rule and rule amendments do not impose new reporting requirements, but do impose recordkeeping requirements on advisers, including small advisers, that exercise voting authority over client securities. The FRFA notes that advisers, generally vote client proxies only when they are managing client assets on a discretionary basis. Small advisers engage in discretionary asset management on a limited scale, and thus should not have to dedicate significant resources to meet the compliance and recordkeeping requirements in connection with their proxy votes.

The FRFA discusses alternatives considered by the Commission in adopting the new rule and rule amendments that might minimize adverse effects on small advisers, including: (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the rule, or any part thereof, for such small entities.

We believe that the flexibility built into the rule provides for differing compliance requirements for small entities. We do not believe that further clarification, consolidation, or simplification of compliance and reporting requirements for small entities or an exemption from the coverage of the rule for small entities would be consistent with investor protection and the fiduciary duty an adviser owes to its clients. The new rule and rule amendments use performance, rather than design standards, in the sense that that they require policies and procedures to ensure votes are in the best interest of clients, rather than specifying specific elements of the policies and procedures.

The FRFA is available for public inspection in File No. S7-38-02. A copy of the FRFA may be obtained by contacting Daniel S. Kahl, Senior Counsel, Securities and Exchange Commission, 450 Fifth Street NW., Washington DC 20549-0506.

## VII. Consideration of Promotion of Efficiency, Competition, and Capital Formation

Section 202(c) of the Advisers Act requires 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>53</sup>

As discussed above, the rule and rule amendments will require investment advisers that have authority to vote clients' securities to adopt and implement written policies and procedures designed to ensure that votes are cast in the clients' best interest.

Although we recognize that compliance programs, including proxy voting programs, may require advisers to expend resources that they could otherwise use in their primary business, we expect that the rules and rule amendments may indirectly increase efficiency in a number of ways. Advisers would be required to carry out their proxy voting in an organized and systematic manner, which may be more efficient than their current approach. Requiring all advisers with voting authority to adopt proxy voting policies and procedures, and meet recordkeeping requirements, may enhance efficiency further by encouraging third parties to create new resources and guidance to which industry participants can refer in establishing, improving, and implementing their proxy voting procedures. In addition, proxy voting policies and procedures may focus advisers on their fiduciary duties in voting client securities, thus increasing efficiency by deterring securities law and common law fraud violations.

Because the rule and rule amendments apply equally to all advisers that exercise voting authority over clients' securities, we do not anticipate that any competitive disadvantages would be created. To the contrary, the rule and rule amendments may encourage competition by raising clients' awareness about advisers' proxy

voting and facilitating the differentiation of services offered by various advisers.

We anticipate that the rule and rule amendments may have a limited indirect effect on capital formation. The rule and rule amendments will likely increase investor confidence in investment advisers by making proxy voting more transparent and encouraging increased emphasis on proxy voting by advisers. Because capital formation is influenced by investor confidence in the markets, we believe that the rule could have a positive effect on capital markets.

## VIII. Statutory Authority

We are adopting new rule 206(4)-6 pursuant to our authority set forth in sections 206(4) and 211(a) of the Advisers Act [15 U.S.C. 80b-6(4) and 80b-11(a)]. We are adopting amendments to rule 204-2 pursuant to the authority set forth in sections 204 and 206(4) of the Advisers Act [15 U.S.C. 80b-4 and 80b-6(4)].

### Text of Rule and Rule Amendments

#### List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

### PART 275—RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

**Authority:** 15 U.S.C. 80b-2(a)(11)(F), 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6a, 80b-11, unless otherwise noted.

\* \* \* \* \*

2. Section 275.204-2 is amended by:

a. Redesignating paragraph (c) introductory text, paragraphs (c)(1) and (c)(2) as paragraph (c)(1) introductory text, paragraphs (c)(1)(i) and (c)(1)(ii) respectively;

b. Adding new paragraph (c)(2); and

c. Revising paragraph (e)(1).

The additions and revisions read as follows:

#### § 275.204-2 Books and records to be maintained by investment advisers.

\* \* \* \* \*

(c) \* \* \*

(2) Every investment adviser subject to paragraph (a) of this section that exercises voting authority with respect to client securities shall, with respect to those clients, make and retain the following:

<sup>53</sup> 15 U.S.C. 80b-2(c). Section 204 of the Advisers Act, which is part of our statutory authority for the proposed recordkeeping amendments for investment advisers under rule 204-2, permits us to prescribe recordkeeping rules that we determine are necessary or appropriate in the public interest or for the protection of investors. Also in this Release, we are adopting new rule 206(4)-6, under other statutory provisions that do not express the same public interest standard, and are not covered by section 202(c). In the interest of comprehensiveness, we nevertheless have included rule 206(4)-6 in our section 202(c) analysis.

<sup>52</sup> 17 CFR 275.0-7(a).