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ICI, IDC File Brief in Case Challenging SEC Proxy Access Rules

"One-Size Fits All" Approach Fails to Recognize Unique Governance Structure and Regulation of Investment Companies

Washington, DC, December 10, 2010 – The Investment Company Institute (ICI) and Independent Directors Council (IDC) filed a friends-of-the-court brief in support of the Business Roundtable's and the U.S. Chamber of Commerce's lawsuit, which seeks to vacate the proxy access rules adopted by the Securities and Exchange Commission. The ICI and IDC brief focuses exclusively on the application of the rules to registered investment companies (or funds) and urges the U.S. Court of Appeals for the District of Columbia Circuit to vacate the rules as they apply to funds.

The rules would permit shareholders to place their director nominees on a company's proxy statement. The ICI and IDC do not oppose proxy access rules *per se* and support in principle the SEC's efforts to further enfranchise shareholders. The ICI and IDC believe, however, that the SEC rules in their present form are unsuited to the unique corporate governance structure of fund companies and boards and could increase costs for investors if implemented.

"It was disappointing that the SEC proceeded with this flawed proxy access rule. Throughout the process, we urged the agency to conduct a thorough cost-benefit analysis – as required by law – to determine how this rule might impact fund investors. Sadly, that analysis never happened," said ICI President and CEO Paul Schott Stevens. "We hope the Court understands the important distinctions between funds and operating companies and vacates this rule."

"Fund shareholders enjoy the unique protections and benefits of existing fund governance practices and structures, which vary significantly from those of operating companies. We were surprised and disappointed that the SEC failed to consider any of these vast differences and applied this rule to funds without conducting any of the necessary analysis to determine if fund shareholders will be harmed by it," said IDC Managing Director Amy Lancellotta.

ICI and IDC Oppose SEC's One-Size-Fits-All Approach to Proxy Access

In their brief, ICI and IDC demonstrate that the SEC focused on how its new proxy access rules would apply to operating companies and failed to consider the very different context presented by funds. As a result, the SEC adopted a "one-size-fits-all" standard that fails to take into account the extensive regulatory requirements and governance structure that are unique to investment companies.

The brief states: "The SEC's ill-conceived regulation of the $11.5 trillion fund industry was arbitrary and capricious. The fund industry is simply too important, and its structure too distinct, for the SEC to regulate as an afterthought. The [Chamber and Business Roundtable] petition for review should be granted, and the rule vacated to the extent that it applies to funds."

SEC Overlooks Key Legal and Economic Issues Related to Funds

The brief outlines the major omissions and flaws related to the SEC's failure to justify sweeping funds under the rule, including:

1. Federal law provides unique protection to fund shareholders. Existing federal law regulating funds sets independence requirements for fund boards; imposes specific responsibilities on independent directors; requires shareholder approval for key fund decisions; and provides an avenue for shareholder lawsuits against an investment adviser for receipt of excessive compensation. There are no comparable provisions with respect to public operating companies.

2. Funds and their shareholders would lose important efficiencies that are unique to funds. Fund complexes generally have adopted specific board structures (known as "unitary or cluster boards") designed to efficiently oversee multiple funds. The many

benefits of these structures—including increasing the board's knowledge of fund operations across the complex, strengthening the board's oversight of the investment adviser, and lowering fund shareholders' expenses – are threatened by the rule, which invites the election of different directors for particular funds within the complex.

3. Applying the rules to funds is wholly inconsistent with a recent SEC action. As recently as July 2009, the SEC approved an exemption for funds from a New York Stock Exchange rule concerning director elections. In doing so, the SEC concluded that "the different regulatory regime for registered investment companies supports the exemption." The SEC offered no explanation for its sudden change in policy.

4. The SEC relied on empirical studies that expressly excluded funds. The SEC failed to conduct studies assessing the rule's impact on the fund industry and relied on empirical studies based on operating companies. Given the unique features of funds, as well as the size of the fund industry, the SEC cannot rationally rely on those studies without considering whether there are meaningful differences between funds and operating companies that require a different analysis.

5. The SEC failed to consider fully the rule's effect on efficiency, competition, and capital formation. The SEC admitted the rule would "increase costs and potentially decrease efficiency" of fund boards. The SEC failed to consider whether current federal law provides "sufficient protections" for shareholders so as to outweigh the obvious efficiency costs of rule. The SEC compounded its error by failing to consider the extent of existing competition in its analysis, because if it had, it would have found that funds exist in a highly competitive market.

ICI and IDC commented on the SEC's proposal during the rule-making process, making many of the arguments included in the brief. The SEC's new proxy rules were scheduled to take effect in time for the next proxy season, but the SEC has delayed their effectiveness until the lawsuit is resolved.

A three-judge panel of the D.C. Circuit Court of Appeals is slated to hear oral arguments in the case on a date to be determined by the Court.
