SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

[Release No. IA-2059; File No. S7-38-02]

RIN 3235-AI65

PROXY VOTING BY INVESTMENT ADVISERS

Agency: Securities and Exchange Commission.

Action: Proposed rule.

Summary: The Commission is publishing for comment a new rule and rule amendments under the Investment Advisers Act of 1940 that would address an investment adviser's fiduciary obligation to clients who have given the adviser authority to vote their proxies. Under our proposal, an investment adviser that exercises voting authority over client proxies would be required to adopt and implement policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of clients, disclose to clients information about those procedures and policies and how clients may obtain information on how the adviser has voted their proxies, and retain certain records relating to proxy voting. The rule and rule amendments are designed to assure that advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted.

Dates: Comments must be received on or before December 6, 2002.

Addresses: To help us process and review your comments more efficiently, comments should be sent by hard copy or e-mail, but not by both methods.

Comments sent by hardcopy should be submitted in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. S7-38-02; if e-mail is used, this file number should be included on the subject line. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Electronically submitted comment letters also will be posted on the Commission's Internet web site (http://www.sec.gov).1

For Further Information Contact: Daniel S. Kahl, Senior Counsel, or Jamey Basham, Special Counsel, at 202-942-0719, Office of Investment Adviser Regulation, Division of Investment Management, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0506.

Supplementary Information: The Securities and Exchange Commission ("Commission" or "SEC") is requesting public comment on proposed rule 206(4)-6 [17 CFR 275.206(4)-6] and proposed amendments to rule 204-2 [17 CFR 275.204-2] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act").

I. Background

Investment advisers today have discretionary investment authority with respect to almost $19 trillion dollars of assets, including large holdings in equity securities.2 In most cases, these advisers are given authority to vote proxies relating to equity securities on behalf of their clients.3 The enormity of this voting power gives advisers significant ability collectively, and in many cases individually, to affect the outcome of shareholder votes and to substantially influence the governance of corporations.4 Advisers are thus in a position to have a significant effect on the future of corporations and the value of securities held by advisory clients.

The federal securities laws do not specifically address how advisers must exercise their voting authority. Under the Advisers Act, an investment adviser is, however, a fiduciary that owes its clients a duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" its clients.5 An adviser owes its client a fiduciary duty with respect to all services undertaken on the client's behalf, including the voting of proxies.6 An adviser's fiduciary duty includes the duty of care and the duty of loyalty to clients. The duty of care requires an adviser given authority to vote proxies to monitor corporate events and to vote the proxies.7 The duty of loyalty requires an adviser to vote proxies in a manner consistent with the best interest of its client and precludes the adviser from subrogating the client's interest to its own.8

The Commission is concerned with conflicts of interest between advisers and their clients. Advisers today frequently have business interests that may expose them to pressure to vote in a manner that may not be in the best interest of their clients.9 Many advisers (or their affiliates) manage assets, administer employee benefit plans, or provide brokerage, underwriting, insurance, or banking services to companies whose management is soliciting proxies. Failure to vote proxies in favor of the management of such a company may harm the adviser's relationship with the company, particularly when there is a contested matter before shareholders. In some cases, the adviser may have a business relationship, not with the company, but with a proponent of a proxy proposal, that may affect how it casts client votes. For example, the adviser may manage money for an employee group.

Other types of conflicts may affect how advisers vote client proxies. The adviser may have personal and business relationships with participants in proxy contests, corporate directors or candidates for corporate directorships, or the adviser may have a personal interest in the outcome of a particular matter before shareholders. For example, an executive of the adviser may have a spouse or other relative who serves as a director of a company or who is employed by the company.

These conflicts are not new. We described them in detail in our 1971 report to Congress on Institutional Investors.10 In 2000, we expressed concern about these conflicts and proposed to require advisers to disclose to clients the policies that they had in place, if any, to address these conflicts.11 The Department of Labor has recognized that they can adversely affect the management of employee benefit plans.12

Under the Act, an adviser with a material conflict of interest must fully disclose that conflict to its client before voting the client's proxy. Many advisers, instead, have adopted policies and procedures that are designed to ensure that client proxies are properly voted, material conflicts are avoided, and fiduciary obligations are otherwise fulfilled.13 Not all advisers have these procedures in place, not all advisers that have procedures make them available to their clients, and not all advisers that vote client proxies make the votes available to clients. The importance of proxy voting by investment advisers - both to their clients and to our system of corporate governance - as well as the many conflicts faced by advisers suggest a need for the Commission to address proxy voting by investment advisers under the Advisers Act. Therefore, the Commission is proposing a new rule under the Advisers Act designed to prevent material conflicts of interest from affecting the manner in which advisers vote client proxies.

II. Discussion

We propose a new rule under section 206(4) of the Act that would require certain advisers to adopt and implement procedures for voting proxies, describe those procedures to their clients, and disclose how clients may obtain information about how the adviser has voted proxies. We are also proposing amendments to rule 204-2 under the Advisers Act to require advisers to keep certain records regarding their proxy votes on behalf of clients.

A. Rule 206(4)-6

Under proposed rule 206(4)-6, it would be a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act for an investment adviser to exercise voting authority with respect to client securities, unless: the adviser has adopted and implements written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, the adviser discloses to clients how they may obtain information on how the adviser voted their proxies, and the adviser has disclosed its proxy voting procedures to its clients.14 We describe each of the elements of the rule below.15

1. Advisers Subject to the Rule

a. Registered Advisers. The rule would apply to advisers registered with the Commission that have voting authority with respect to client securities. Rule 206(4)-6, like our other anti-fraud rules under the Advisers Act, would not apply to smaller advisers that are registered with state securities authorities. Since the enactment of the National Securities Markets Improvement Act in 1996 ("NSMIA"), we have deferred to state securities authorities the regulation of these advisers, which do not have voting authority over substantial amounts of assets.16 The rule would also not apply to advisers that rely on an exemption from registration under section 203(b) of the Act,17 such as those advisers that have had fewer than 15 clients during the last twelve months, which we do not examine and to which most other provisions of the Act do not apply.

We request comment on the scope of proposed rule 206(4)-6. Should the rule apply to state-registered advisers? Should it apply to advisers that rely on an exemption from registration under section 203(b) of the Act?

b. Advisers with Voting Authority. Because we are concerned primarily with the proper exercise of voting authority of client proxies, only advisers that have voting authority would be subject to the rule.18 Advisers whose clients retain voting authority would not be required to adopt procedures or policies and would not be required to make any disclosures to clients under the rule. The rule would therefore not apply if an adviser provides a client with advice only as to how the client should vote a proxy. We are concerned that applying the rule to such advisers could result in numerous unintentional violations of the rule if, for example, a financial planner that never votes client proxies (and thus does not have policies and procedures and has not made the required disclosures) were to respond to a question from a client. The Advisers Act's general anti-fraud provisions would continue to apply, requiring the planner to disclose any material conflict that it may have to the client receiving the advice.

Comment is requested regarding whether we should require all registered advisers to have policies and procedures.

Are there circumstances where an adviser with authority to vote client proxies should be exempt from the rule's requirements?

In some cases, clients retain some authority over the proxy vote, e.g., the client retains voting authority with respect to certain issues or the contract provides that the adviser should consult with the client on voting matters. How should the rule apply in these circumstances?

2. Written Policies and Procedures

Rule 206(4)-6 would require investment advisers subject to the rule to adopt and implement written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of clients.19 Although advisers' proxy voting policies typically include a number of common elements,20 we are not proposing to specify the procedures or policies that advisers must adopt.

Investment advisers registered with us have such different types of conflicts and organizational structures that we believe a "one-size-fits-all" approach would not work.21

The rule would, however, contain three requirements. First, the proxy voting policies and procedures must be written.22 Second, they must describe how the adviser addresses material conflicts between its interests and those of its clients with respect to proxy voting. Finally, the policies and procedures must address how the adviser resolves those conflicts in the best interest of clients. The rule thus incorporates the standard that we believe applies to advisers as fiduciaries under the Advisers Act.23 We have included the standard in the proposed rule to clarify the obligation of advisers and to require that the best interest of clients be the focus of the policies and procedures.24

In addition, we believe effective proxy voting policies and procedures of an adviser should identify personnel responsible for monitoring corporate actions, describe the basis on which decisions are made to vote proxies, and identify personnel (or groups) involved in making voting decisions and those responsible for ensuring that proxies are submitted in a timely manner. The extent to which the adviser relies on the advice of third parties or delegates to committees should also ordinarily be covered by the policies. Of course, the scope of the policies and procedures will turn on the nature of the adviser's advisory business, the types of securities portfolios it manages, and the extent to which clients, such as registered investment companies, have adopted their own procedures.25

Many advisers may also be subject to fiduciary standards under ERISA and state common law.26 We believe that the "best interest" standard in the proposed rule is not inconsistent with those laws in any material respect.

Is the standard we have set forth in the rule clear?

Are there conflicts with other laws that we should address?

Should we include in the text of the rule additional required policies and procedures?

Alternatively, should we include in our adopting release additional policies and procedures that we believe are "best practices" for advisers to adopt? Commenters favoring additional policies and procedures should give specific recommendations.

3. Disclosure of How Clients Can Obtain Information on Votes

Rule 206(4)-6 would also require an adviser subject to the rule to disclose to clients how they can obtain information from the adviser on how the adviser voted their proxies.27 We propose this provision for similar reasons to those we set forth in our companion release that would require investment companies to disclose how they have voted their proxies. 28 We believe that "sunshine" on these votes will lead advisers to pay greater attention to their fiduciary obligations. Fully informed clients will serve as a check on their advisers' exercise of voting authority: clients who disapprove of how advisers vote their proxies may decide to reclaim the responsibility to vote proxies, provide the adviser with instructions on how to vote their proxies, or seek a different adviser whose voting policies they approve.

Our proposal - which would require disclosure of how a client can obtain information - would not prescribe a right to that information. We assume that clients have a right to information about how their own proxies have been voted.29 And, unlike our investment company proposals, the proposed rule would not prescribe the nature, format, or scope of the information that must be disclosed. Many clients may not be interested in how the adviser votes. Those who are interested would typically only be entitled to know how the adviser has voted his or her proxies (and not those of other clients), and may need (or want) information only about one or a few critical votes. Requiring an adviser to prepare a list of votes for each client (most of whom may never request the information), specifying the time periods the information must cover (which time periods may not be responsive to a particular request), and the

content of the information provided in the lists seems to us unnecessarily burdensome. Therefore, we would leave those decisions to clients and their advisers, which we would expect to be responsive to client requests.

We request comment on our assumption that clients have the right to information about how their shares have been voted. Have advisers denied this information to clients? Should we include in the rule a right to this information? If so, what should be the scope of the right? For how many years should the adviser be required to retain information about votes and produce it upon request for a client?

Should the rule prescribe the content and format of required disclosures, as would the investment company rules we are proposing? If so, should the content and format of the required disclosure be different in any way from the proposed investment company rules?

4. Describe Policies and Procedures to Clients

Finally, the proposed rule would require advisers subject to the rule to describe their proxy voting policies and procedures to clients and, upon request, furnish a copy of the policies and procedures to clients.30 This disclosure would help clients understand how the adviser votes proxies and permit clients to select advisers whose procedures and policies meet their expectations.31 Disclosure should also serve to encourage more effective policies and procedures.32

B. Amendments to Rule 204-2

We are also proposing to amend rule 204-2 under the Advisers Act to require advisers subject to rule 206(4)-6 to keep relevant records.33 These records would permit our examiners to ascertain compliance with the rule. They would also be necessary for an adviser to comply with the proposed requirement to disclose how the adviser has voted proxies for clients.

Under the proposed rule amendments, each adviser subject to rule 206(4)-6 would be required to keep its proxy voting policies and procedures, records of proxy statements received, records of votes cast, records of all communications received and internal documents created that were material to the voting decision, and a record of each client request for proxy voting records and the adviser's response.34 We are proposing to require advisers to maintain proxy voting books and records in an easily accessible place for five years, the first two years in an appropriate office of the investment adviser.35

III. General Request for Comment

The Commission requests comment on the rule and amendments proposed in this release, suggestions for other additions to the rule and amendments, and comment on other matters that might have an effect on the proposals contained in this release. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, the Commission also requests information regarding the potential impact of the proposed rule and amendments on the economy on an annual basis. Commenters should provide empirical data to support their views.

IV. Paperwork Reduction Act

The proposed rule and amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.36 One of the collections of information is new. The Commission has submitted this new collection to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. The title of this new collection is "Rule 206(4)-6;" OMB has not yet assigned it a control number. The other collection of information takes the form of amendments to a currently-approved collection titled "Rule 204-2," under OMB control number 3235-0278. The Commission has also submitted the amendments to this collection to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a

person is not required to respond to, a collection of information unless it displays a currently valid control number.

The collection of information under rule 206(4)-6 is necessary to assure that investment advisers that vote proxies for their clients vote those proxies in their clients' best interest and provide their clients information about how their proxies were voted. This collection of information is mandatory. The respondents are investment advisers registered with us that vote proxies with respect to clients' securities. Clients of these investment advisers use the information collected to assess investment advisers' proxy voting policies and procedures and to monitor the adviser's performance of its proxy voting activities. Responses to the disclosure requirements are not kept confidential.

The collection of information under rule 204-2 is necessary for the Commission staff to use in its examination and oversight program. This collection of information is mandatory. The respondents are investment advisers registered with us that vote proxies with respect to clients' securities. Responses provided to the Commission in the context of its examination and oversight program are generally kept confidential.37 The records that an adviser must keep in accordance with rule 204-2 must generally be retained for not less than five years.38

A. Rule 206(4)-6

According to our records, 6,203 of the 7,687 total advisers registered with the Commission manage client assets on a discretionary basis.39 For purposes of estimating the paperwork burden for investment advisers under proposed rule 206(4)-6, we will infer that these advisers vote proxies on behalf of one or more clients in connection with providing discretionary asset management services.40 We further estimate that each of these advisers would be required to spend on average 10 hours annually documenting its proxy voting procedures under the requirements of the proposed rule, for a total burden of 62,030 hours.41 In preparing this estimate, we have taken into account the fact that many advisers subject to ERISA because they manage plan assets already have proxy voting procedures in place which can serve as the basis of the adviser's procedures under the proposed rule.

The proposed rule also would require these advisers to describe their proxy voting policies and procedures to clients. The attendant paperwork burden is already incorporated in a collection of information titled "Form ADV," which is currently approved by OMB under control number 3235-0049.42 In addition, the proposed rule would require these investment advisers to provide copies of their proxy voting policies and procedures to clients upon request. While we estimate that SEC-registered advisers have, on average, 670 clients each,43 we estimate that, on average, at least 90 percent of each of these adviser's clients would find the adviser's description of its policies sufficiently informative, and ten percent at most, or 67 clients of each adviser on average, would request copies of the underlying policies and procedures.44 We estimate that it would take these advisers 0.1 hours per client to deliver copies of the policies and procedures, for a total burden of 41,560 hours.45

Accordingly, we estimate that proposed rule 206(4)-6 would increase the annual aggregate burden of collection for SEC-registered investment advisers by a total of 103,590 hours.46

B. Rule 204-2

The currently-approved annual aggregate burden of collection under rule 204-2 is 1,582,293 hours. This approved annual aggregate burden was based on estimates that 8,100 advisers were subject to the rule, and each of these advisers spend an average of 195.34 hours each preparing and preserving records in accordance with the rule. Updating those prior calculations based on current information from SEC-registered investment advisers, however, we would now estimate that 7,687 are subject to the rule. We would continue to estimate that each of these advisers spend an average of 195.34 hours each preparing and preserving records in accordance with the rule. These current data would decrease the

annual aggregate burden under the rule to 1,501,578.5 hours,47 which is a reduction of 80,714.5 hours.48

The proposed amendments to rule 204-2 would require registered investment advisers that vote client proxies to maintain specified records with respect to those clients. These advisers must maintain copies of their policies and procedures that would be required under proposed rule 206(4)-6, as well as copies or records of each proxy statement received with respect to the securities of clients for whom the adviser exercises voting authorities. These advisers must also maintain a record of each vote cast, as well as a record of all communications received and all internal documents created that were material to the adviser's decision on the vote. In addition, the adviser would be required to maintain a record of each client request for proxy voting information and the adviser's response. The adviser would be required to maintain these records in the same manner, and for the same period of time, as other books and records are currently required to be maintained under rule 204-2(e)(1).

We estimate that these proposed amendments would increase the average annual collection burden of an adviser subject to the amendments by 20 hours, to 215.34 hours.49 As discussed above in connection with proposed rule 206(4)-6, we estimate that 6,203 advisers exercise voting authority on behalf clients and will thus be subject to this additional burden, for an annual aggregate burden increase of 124,060.50 The average annual burden for SEC-registered investment advisers under rule 204-2 would accordingly increase from 195.34 hours to 211.48 hours.51

C. Request for Comment

We request comment whether these estimates are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments to:

- evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information;
- determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 3208, Washington, DC 20503, and also should send a copy to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609 with reference to File No. S7-38-02. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives the comment within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-38-02, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 450 Fifth Street, NW, Washington, DC 20549.

V. Cost-Benefit Analysis

We are sensitive to the costs and benefits resulting from our rules. While investment advisers exercise enormous proxy voting power as part of their discretionary management of their clients' securities, the federal securities laws do not specifically address how advisers must exercise this voting authority.

Proposed rule 206(4)-6 is designed to ensure that advisers vote client securities in the client's best interest and to provide clients information on how their securities are voted.

Investment advisers today have discretionary investment authority with respect to almost $19 trillion dollars of assets, including large holdings in equity securities. In most cases, these advisers are given authority to vote proxies on equity securities on behalf of their clients. Under the Advisers Act, investment advisers are fiduciaries that must act in their clients' best interest with respect to functions undertaken on behalf of their clients, including these proxy voting activities. An adviser's fiduciary duty includes the duty of care and the duty of loyalty to clients. For an adviser that has been given authority to vote proxies, the duty of care includes the duty to monitor corporate events and vote proxies; the duty of loyalty requires the adviser to vote proxies in a manner consistent with the best interest of its client and precludes the adviser from subrogating the client's interest to its own.

The Commission is concerned with conflicts of interest between advisers and their clients. Advisers (or their affiliates) frequently manage assets, administer employee benefit plans, or provide brokerage, underwriting, or insurance services to companies whose management is soliciting proxies. These business interests may expose advisers to pressure to vote in favor of management. Other business relationships may expose advisers to pressure to vote in favor of the proponent of a proxy question, such as when an adviser manages money for an employee group. In other instances, advisers may be exposed to pressure as a result of personal relationships with participants in proxy contests, corporate directors, or candidates for directorships.

The importance of proxy voting by investment advisers - both to their clients and to our system of corporate governance - as well as the many conflicts faced by advisers suggest a need for the Commission to address proxy voting by investment advisers under the Advisers Act. While many advisers have adopted policies and procedures designed to ensure that client proxies are properly voted, material conflicts are avoided, and fiduciary obligations are fulfilled, others do not have these procedures in place.

Therefore, the Commission is proposing a new rule under the Advisers Act designed to prevent material conflicts of interest from affecting the manner in which advisers vote client proxies. We have identified certain costs and benefits of the proposed rule and rule amendments. We request comment on the costs and benefits of the proposed rule amendments, and encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or any additional costs or benefits.

A. Background

Proposed rule 206(4)-6 is designed to ensure that advisers vote client securities in the client's best interest and to provide clients information on how their securities are voted. The proposed rule would require an SEC-registered investment adviser that votes client proxies to adopt written policies and procedures reasonably designed to ensure the adviser votes proxies in the best interest of the client, including procedures to address any material conflict that may arise between the interest of the adviser and the client. The proposed rule would also require the adviser to describe these policies and procedures to clients, and to provide copies of the policies and procedures to clients upon their request. In addition, the proposed rule would require these advisers to disclose to clients how they may obtain information from the adviser about how the adviser voted their proxies.

We are not proposing to specify the procedures or policies that advisers must adopt under the proposed rule. Investment advisers registered with us have such different types of conflicts and organizational structures that we believe a "one-size-fits-all" approach would not work. The rule would, however, require written procedures that describe how the adviser addresses material conflicts between its interests and those of its clients with respect to proxy voting, and how the adviser resolves those conflicts in the best interest of clients. The rule thus incorporates the standard that we believe applies to advisers as fiduciaries under the Advisers Act.

We are also proposing amendments to rule 204-2 under the Advisers Act that would require registered investment advisers that vote client proxies to maintain specified records with respect to those clients. These advisers would be required to maintain copies of the policies and procedures to be required under proposed rule 206(4)-6, as well as copies or records of each proxy statement received with respect to the securities of clients for whom the adviser votes proxies. These advisers must also maintain a record of each vote cast, as well as a record of all communications received and all internal documents created that were material to the adviser's decision on the vote. In addition, the adviser would be required to maintain a record of each client request for proxy voting information and the adviser's response. These records would permit our examiners to ascertain compliance with the rule. They would also be necessary for an adviser to comply with the proposed requirement to disclose how the adviser has voted proxies for clients.

Based on advisers' filings with us, we estimate that the majority of investment advisers registered with us vote proxies on behalf of their clients. SEC-registered advisers are not currently required to submit information to us describing their proxy voting practices. However, according to our records as of September 9, 2002, 6,203 of the 7,687 total advisers registered with us manage client assets on a discretionary basis.52 Since in most instances advisers with discretionary investment authority are given authority to vote proxies relating to equity securities under management, it is likely that significant numbers of these 6,203 advisers vote proxies on behalf of one or more clients in connection with providing discretionary asset management services.53

B. Benefits

Advisory clients will receive benefits from the proposed amendments. The proxy voting procedures contemplated under the rule will ensure that advisers have a system in place designed to identify and address any material conflicts of interest with respect to each proxy voted by the adviser on a client's behalf, and to vote the proxy in the client's best interest. Many advisers may be exposed to varying types of conflicts from differing sources, and it benefits clients when advisers take special measures to ensure that all conflicts are properly addressed.

The proposed rule would also require these advisers to describe their proxy voting policies and procedures to clients, and require the adviser to furnish copies of the policies and procedures to clients upon request. Clients will benefit from this disclosure by gaining an understanding of how the adviser votes proxies. Clients will be in a better position to determine whether their adviser's policies and procedures meet their expectations.

In addition, the proposed rule requires advisers to disclose to their clients how they can obtain information on how the adviser voted their proxies. Fully informed clients will serve as a check on their advisers' exercise of voting authority: clients who disapprove of how advisers vote their proxies may decide to reclaim the responsibility to vote proxies, provide the adviser with instructions on how to vote their proxies, or seek a different adviser whose voting policies they approve.

These potential benefits to clients are difficult to quantify. In addition, some clients may already be receiving some of these benefits in certain instances; applicable law entitles clients to their adviser's fiduciary care and loyalty in connection with proxy voting, as well as information about how their proxies were voted, and some advisory firms have adopted policies and procedures addressing proxy voting. To the extent clients are receiving these benefits as a matter of practice, the potential benefit of having these practices institutionalized through a rule is also difficult to quantify.

C. Costs

The proposed rule and rule amendments would impose some costs on advisers that vote client proxies. These advisers would incur costs in connection with establishing and operating the procedures

contemplated by the proposed rule, and in connection with expanding their recordkeeping systems to include new material on proxy voting. These advisers would also incur costs in preparing descriptions of their policies and procedures for clients, as well as in responding to client requests for copies of the advisers' policies and procedures. Finally, these advisers would incur costs in responding to any client requests for information about how the adviser voted the client's proxies.

The initial and ongoing compliance costs imposed by the proposed rule would vary significantly among advisers based on several factors that are as diverse as the differing types of advisory firms and clients affected by the proposal. For example, firms that invest their clients' assets in numerous equity issues must review more proxy votes than firms that invest their clients' assets in few equity issues.54 Firms with a wide diversity of business and individual advisory clients may be more likely to face conflicts than other firms, and firms that are part of financial organizations that provide other financial services may face more conflicts than stand-alone firms. Clients of a "social investing" firm may be keenly interested in the firm's proxy voting practices, but the firm is likely to have already developed systems that would largely address the proposed requirements. Clients of other firms may be interested in how the adviser votes only rarely, with regard to high-profile proxy contests, and the firm's cost of responding to client inquiries is likely to be small.

In addition, we believe that many advisers that would be affected by the proposed rule have already developed proxy voting policies and procedures, and would incur fewer new costs as a result. Investment advisers subject to ERISA because they manage retirement plan assets vote client proxies in many instances, and through our investment adviser inspection program, we have determined that this group of advisers typically has proxy voting policies and procedures in place. These advisers could likely use some, or all, of these procedures to meet the obligations under the proposed rules. Moreover, many of these advisers are the larger firms that would likely incur the most costs associated with the proposed rules.

In connection with estimating the annual aggregate burden of the proposed rule and amendments for purposes of the Paperwork Reduction Act, Commission staff has estimated that advisory firms affected by the rule will incur staff salary and benefit costs aggregating approximately $5,775,000 to prepare and maintain the documents and records required under the proposal.55 This is an aggregate estimate, and each firm's individual costs in this regard will vary depending on the nature of the firm's advisory business and clients, as discussed above. Moreover, many firms that are subject to ERISA because they manage retirement plan assets already have proxy voting policies and procedures in place, as discussed above, and are already incurring some portion of these costs.

D. Request for Comment

The Commission requests comment on the potential costs and benefits identified in this release, as well as any other costs or benefits that may result from the proposal.

We encourage commenters to identify, discuss, analyze, and supply relevant data regarding these or additional costs and benefits.

VI. Initial Regulatory Flexibility Analysis

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") regarding proposed rule 206(4)-6 and proposed amendments to rule 204-2 in accordance with section 3(a) of the Regulatory Flexibility Act.56

A. Reasons for Proposed Action

While investment advisers exercise enormous proxy voting power as part of their discretionary management of their clients' securities, the federal securities laws do not specifically address how

advisers must exercise this voting authority. Investment advisers today have discretionary investment authority with respect to almost $19 trillion dollars of assets, including large holdings in equity securities. In most cases, these advisers are given authority to vote proxies on equity securities on behalf of their clients. Under the Advisers Act, investment advisers are fiduciaries that must act in their clients' best interest with respect to functions undertaken on behalf of their clients, including these proxy voting activities. An adviser's fiduciary duty includes the duty of care and the duty of loyalty to clients. For an adviser that has been given authority to vote proxies, the duty of care includes the duty to monitor corporate events and vote proxies; the duty of loyalty requires the adviser to vote proxies in a manner consistent with the best interest of its client and precludes the adviser from subrogating the client's interest to its own.

The Commission is concerned with conflicts of interest between advisers and their clients. Advisers (or their affiliates) frequently manage assets, administer employee benefit plans, or provide brokerage, underwriting, or insurance services to companies whose management is soliciting proxies. These business interests may expose advisers to pressure to vote in favor of management. Other business relationships may expose advisers to pressure to vote in favor of the proponent of a proxy question, such as when an adviser manages money for an employee group. In other instances, advisers may be exposed to pressure as a result of personal relationships with participants in proxy contests, corporate directors, or candidates for directorships.

The importance of proxy voting by investment advisers - both to their clients and to our system of corporate governance - as well as the many conflicts faced by advisers suggest a need for the Commission to address proxy voting by investment advisers under the Advisers Act. While many advisers have adopted policies and procedures designed to ensure that client proxies are properly voted, material conflicts are avoided, and fiduciary obligations are fulfilled, others do not have these procedures in place. Therefore, the Commission is proposing a new rule under the Advisers Act designed to prevent material conflicts of interest from affecting the manner in which advisers vote client proxies.

B. Objectives and Legal Basis

Proposed rule 206(4)-6 is designed to ensure that advisers vote client securities in the client's best interest and to provide clients information on how their securities are voted. The proposed rule would require an investment adviser that votes client proxies to adopt written policies and procedures reasonably designed to ensure the adviser votes proxies in the best interest of the client, including procedures to address any material conflict that may arise between the interest of the adviser and the client. The proposed rule would also require the adviser to disclose to clients information about those procedures and policies and how clients may obtain information on how the adviser has voted their proxies. The Commission is also proposing amendments to rule 204-2 to require advisers that vote client proxies to keep certain records regarding the proxy votes.

The proposed rule and amendments will serve three main objectives. First, the written policies and procedures required under proposed rule 206(4)-6 are designed to ensure that an adviser voting proxies on behalf of its client fulfills its fiduciary duties, including its duty to address any material conflict between the adviser's interests and those of its client. Second, the disclosures required under proposed rule 206(4)-6 are designed to provide clients with a greater understanding of their adviser's proxy voting practices, permit clients to determine whether their adviser's policies and procedures meet their expectations, and serve as a check on their advisers' exercise of voting authority if they disapprove of votes cast on their behalf. Third, the amendments to rule 204-2 will clarify the recordkeeping obligations an adviser has with respect to voting client securities and provide our examiners a means to assess compliance with proposed rule 206(4)-6.

The Commission is proposing rule 206(4)-6 pursuant to the 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)] and 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)]. Section 206(4) gives us authority to issue rules designed to prevent fraudulent, deceptive, or manipulative acts or practices. Section 211 gives us authority to clarify, by rule, persons and matters within our jurisdiction and to prescribe different requirements for different classes of persons, as necessary or appropriate to the exercise of our authority under the Act. Section 204 gives us authority, by rule, to require an investment adviser to make and keep records.

C. Small Entities Subject to Rule

Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (i) has assets under management having a total value of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had $5 million or more on the last day of its most recent fiscal year.57 The Commission estimates that as of September 9, 2002 approximately 138 SEC-registered investment advisers that might potentially be affected by the rule were small entities.58

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule and rule amendments would impose no new reporting requirements. The proposed rule and rule amendments would create certain new compliance and recordkeeping requirements. The proposed rule imposes a new compliance requirement by making it unlawful for an SEC-registered investment adviser to vote proxies on behalf of clients unless the adviser has adopted written policies and procedures on proxy voting. The proposed rule amendments impose new recordkeeping requirements by requiring these advisers to maintain certain records regarding proxy voting.

Small advisers would only expend efforts to meet these new compliance and recordkeeping requirements to the extent these advisers have authority to vote proxies on behalf of their clients. Advisers typically vote client proxies in connection with managing client assets on a discretionary basis, and small advisers engage in discretionary asset management on a limited scale. Therefore, it is likely that these advisers will make relatively few proxy votes on behalf of their clients, and will not have to dedicate significant resources to comply with the compliance and recordkeeping amendments in connection with those votes.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate or conflict with the proposed rule. Proposed rule 206(4)-6 overlaps with certain provisions of ERISA.59 Pursuant to the Department of Labor's interpretation of sections 402, 403, and 404 of ERISA, an investment manager that has delegated authority to manage plan assets has a fiduciary obligation to vote proxies that affect the value of plan investments unless the investment management contract expressly precludes the manager from voting proxies.60 The interpretation also states that the investment manager is required to maintain records as to proxy voting.61 The provisions of ERISA do not apply to all investment advisers registered with us, but do apply to those investment advisers that meet the ERISA definition of investment manager.62 We do not believe our proposed rule and rule amendments conflict with the obligations that an investment adviser may have under ERISA.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objectives, while minimizing any adverse impact on small entities. In connection with the proposed rule, the Commission considered the following alternatives: (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.

The Commission has drafted proposed rule 206(4)-6 to permit each firm subject to the rule to design and structure its own policies and procedures in light of the firm's operational structure and the particular types of conflicts encountered by the firm in connection with its unique business and clients. In the same way, the proposed amendments to rule 204-2 would permit each firm to develop its own system for capturing and retaining the requisite information. In connection with considering whether to establish differing compliance or recordkeeping requirements or timetables for small entities, as well as whether to use performance rather than design standards, the Commission believes at this time that the flexibility already built in to the proposal adequately addresses these alternatives.

In considering whether to attempt to clarify, consolidate, or simplify the compliance and recordkeeping requirements under the rule for small entities, the Commission believes at this time that the proposal achieves the appropriate balance between simplicity and investor protection, and any further simplification would unacceptably compromise such protection. The minimum criteria specified for proxy voting procedures and client disclosures under proposed rule 206(4)-6 are designed to ensure advisers vote proxies in the best interest of their clients and provide clients information about how their securities are voted. Elimination of some or all of these criteria would potentially impede achievement of that objective. Similarly, in establishing the categories of records to be retained under the proposed amendments to rule 204-2, the records described by the rule are all necessary if the Commission is to be able to evaluate advisers' compliance with proposed rule 206(4)-6 as part of the Commission's inspection program.

Finally, the Commission believes that it would be inconsistent with the purposes of the Advisers Act to exempt small entities from the proposed rule and rule amendments. The proposed policies and procedures are designed to ensure clients are afforded the full protections attendant to an adviser's fiduciary duties as recognized by the Adviser's Act when an adviser is voting their proxies. The proposed disclosure requirements would provide advisory clients with information about its adviser's proxy voting policies and procedures and instruct clients how to obtain information on how the adviser voted their proxies. Different disclosure requirements would leave some advisory clients without the requisite information necessary to assess their adviser's proxy voting practices. Since the protections of the Advisers Act are intended to apply equally to clients of both large and small advisory firms, it would be inconsistent with the purposes of the Act to specify different requirements for small entities.

G. Solicitation of Comment

We encourage written comments on matters discussed in the IRFA. In particular the Commission seeks comment on:

- the number of small entities that would be affected by the proposed rule and rule amendments; and
- whether the effects of the proposed rule and rule amendments on small entities would be economically significant.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of the effect.

VII. Statutory Authority

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

List of Subjects in 17 CFR Part 275

Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be 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:

(i) All policies and procedures required by § 275.206(4)-6.

(ii) A copy of each proxy statement that you receive regarding client securities.

(iii) A record of each vote cast by the investment adviser on behalf of a client.

(iv) A record of all oral and a copy of all written communications received and memoranda or similar documents created by the investment adviser that were material to making a decision on voting client securities.

(v) A record of each client request for proxy voting information and the investment adviser's response, including the date of the request, the name of the client, and date of the response.

* * * * *

(e)(1) All books and records required to be made under the provisions of paragraphs (a) to (c)(1)(i), inclusive, and (c)(2) of this section (except for books and records required to be made under the provisions of paragraphs (a)(11) and (a)(16) of this section), shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made on such record, the first two years in an appropriate office of the investment adviser.

* * * * *

3. Section 275.206(4)-6 is added to read as follows:

§ 275.206(4)-6 Proxy voting.

If you are an investment adviser registered or required to be registered under section 203 of the Act (15 U.S.C. 80b-3), it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act (15 U.S.C. 80b-6(4)), for you to exercise voting authority with respect to client securities, unless you:

(a) Adopt and implement written policies and procedures that are reasonably designed to ensure that you vote client securities in the best interest of clients, which procedures must include how you address material conflicts that may arise between your interests and those of your clients;

(b) Disclose to clients how they may obtain information from you about how you voted with respect to their securities; and

(c) Describe to clients your proxy voting policies and procedures and, upon request, furnish a copy of the policies and procedures to the requesting client.

By the Commission.

Margaret H. McFarland
Deputy Secretary

September 20, 2002

Footnotes

1 We do not edit personal or identifying information, such as names or E-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

2 Approximately $7 trillion of these assets are held by mutual funds. In a companion release, we are also publishing proposed amendments that would require mutual funds to disclose policies and procedures they use to vote proxies on their portfolio securities, and to make available to their shareholders the specific proxy votes they cast. See Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Investment Company Act Release No. 25739 (Sept. 20, 2002).

3 In the mid 1990s, the Commission approved rule changes submitted by the New York Stock Exchange, the National Association of Securities Dealers, Inc., and the American Stock Exchange to allow investment advisers to receive proxy materials and to vote proxies on behalf of the beneficial owners of securities. See, e.g., Order Approving Proposed Rule Changes by the NASD, Securities Exchange Act Release No. 35681 (May 5, 1995) [60 FR 25749 (May 12, 1995)].

4 See generally Board of Governors of the Federal Reserve System, Flow of Funds Accounts of the U.S., Flows and Outstandings, First Quarter 2002 (June 6, 2002) (at table L. 213) (data indicate institutional investors control approximately 50% of the outstanding corporate equities in the United States); A. A. Sommer, Jr., Symposium: Defining the Corporate Constituency: Corporate Governance in the Nineties: Managers vs. Institutions, 59 U. Cin. L. Rev. 357 (Fall 1990) (discussing the "profound" effects of institutional ownership and the inevitable influence it will have on management conduct, the laws governing corporations and fiduciaries, and the American economy); Beth Healy, Big Investors Assuming a More Activist Stance, The Boston Globe, July 11, 2002, at C1 (discussing an activist stance by several large institutional investors on corporate governance issues).

5 SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194 (1963) (interpreting section 206 of the Advisers Act [15 U.S.C. 80b-6]).

6 Unlike the anti-fraud provisions in other provisions of the federal securities laws, section 206 is not limited to fraud in connection with securities transactions. The relevant provisions of section 206 do not refer to dealings in securities, but are stated in terms of the effect of the prohibited conduct on clients. Sections 206(1), 206(2), and 206(4) [15 U.S.C. 80b-6(1), 80b-6(2), 80b-6(4)].

7 We do not mean to suggest, however, that an adviser that fails to vote a proxy would thereby violate its fiduciary obligations to its client under the Act. There may be good reasons for an adviser to refrain from voting a proxy when, for example, the cost of voting the proxy exceeds the expected benefit. An adviser may not, however, ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies.

8 The scope of the adviser's responsibilities with respect to voting proxies would ordinarily be determined by the adviser's contract with its client, and the investment objectives and policies of its client. We are not addressing in this release the extent to which advisers must or should become "shareholder activists," such as actively engaging in soliciting proxies or supporting or opposing matters before shareholders. As a practical matter, advisers will determine whether to engage in such activism based on a cost-benefit analysis of the considered activism. See Robert C. Pozen, Institutional Investors: The Reluctant Activists, Harv. Bus. Rev., Jan.-Feb. 1994, at 140. In conducting this analysis, the adviser might consider the size of the client's position in the company, the nature of the action proposed to be taken, the cost of the particular course of action, and the probable effect of the proposed action, if any, on the value of the client's securities.

9 See Employee Benefit Research Institute Issue Brief, Voting Private Pension Proxies: Some New Evidence and Some Old Questions, (Sept. 1987) (No. 70 at 21) (reporting 65% of investment managers surveyed experienced direct or indirect pressure regarding proxy voting).

10 U.S. Securities and Exchange Commission, Institutional Investor Study Report of the Securities and Exchange Commission, in H.R. Doc. No. 92-64, Part 5.E. at 2749-2763; See also Betty Linn Krikorian, Fiduciary Standards in Pension and Trust Fund Management (1989), at 210-219; James E. Heard and Howard D. Sherman, Investor Responsibility Research Center, Conflicts of Interest in the Proxy Voting System (1987).

11 Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (Apr. 5, 2000) [65 FR 20524 (Apr. 17, 2000)] at n. 192. In addition, former Commissioner Carey highlighted similar concerns about proxy voting by advisers in a December 1999

speech; Paul R. Carey, Remarks to the Investment Company Institute Procedures Conference (Dec. 9, 1999), (available at http://www.sec.gov/news/speech/speecharchive/1999/spch335.htm).

12 Department of Labor, Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Guidelines, 29 CFR 2509.94-2 (2001) ("DOL Interp. Bulletin"). The bulletin states that under the Employee Retirement Income Security Act of 1974 [29 USC 1001, et. seq.] ("ERISA") the fiduciary act of managing ERISA assets includes the voting of proxies, and in voting those proxies the fiduciary may only consider the best interest of plan participants. Many investment advisers are "investment managers," that are delegated authority to manage plan assets and vote plan proxies under ERISA. When managing plan assets and voting proxies, advisers are also subject to the fiduciary standards of ERISA.

13 See generally Association for Investment Management and Research, Standards of Practice Handbook, The Code of Ethics and The Standards of Professional Conduct (1999) (Eighth Edition at 161) (discussing elements of a proxy voting system to allow investment advisers to meet their fiduciary obligation when voting proxies).

14 Section 206(4) of the Act [15 U.S.C. 80b-6(4)] gives the Commission authority to adopt rules "reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive or manipulative." We are proposing rule 206(4)-6 as a means that we believe is reasonably necessary to prevent advisers from defrauding their clients in connection with the exercise of their proxy voting authority.

15 Nothing in this proposal reduces or alters any fiduciary obligation applicable to any investment adviser (or person associated with any investment adviser).

16 See section 203A of the Advisers Act, [15 U.S.C. 80b-3a], enacted as part of Title III of NSMIA. Pub. L. No. 104-290, 110 Stat. 3416 (1996) (codified in scattered sections of the U.S. Code). NSMIA allocated regulatory authority for advisers with less than $25 million of assets under management to state securities authorities. After NSMIA, our authority under section 206 continues to extend to state-registered advisers. However, when we adopted rules implementing NSMIA in 1997, we revised the anti-fraud rules under section 206 to apply only to SEC-registered investment advisers because the rules "contain prophylactic provisions, and that after the effective date of [Title III of NSMIA] the application of these provisions to state-registered advisers is more appropriately a matter of state law." Rules Implementing Amendments to the Investment Advisers Act of 1940, Investment Advisers Act Release No. 1633 (May 15, 1997) [62 FR 28112 (May 22, 1997)].

17 17 U.S.C. 80b-3(b).

18 Some advisory contracts do not explicitly give the adviser voting authority. Instead, the adviser's authority to vote proxies is implied in the overall delegation of authority provided in the advisory contract, power of attorney, trust instrument or other document. Advisers entering into such contracts would be subject to the rule. Cf. DOL Interp. Bulletin, supra note 12 (if the investment management agreement does not expressly preclude the investment manager from voting proxies, the investment manager has the exclusive responsibility for voting).

19 Proposed rule 206(4)-6(a). Nothing in the proposed rule would prevent an adviser from having different policies and procedures for different clients. Thus, the board of directors of an investment company could adopt and require an investment adviser to use different policies and procedures than the adviser uses with respect to its other clients.

20 These common elements frequently deal with policies on particular types of matters that may be presented to shareholders, such as changes in corporate governance, changes in corporate structures, adoption or amendments to compensation plans (including stock options) and matters involving social

issues or corporate responsibility. See supra note 2, Disclosure of Proxy Voting Policies and Proxy Voting Records By Registered Management Investment Companies, at Section II.A.

21 Advisers registered with the Commission have assets under management that range from $580,000,000,000 to $7,020. While 4,923 are organized as corporations (of which 3,265, or 66%, have financial industry affiliations), 367 are organized as sole proprietorships (of which 118, or 32%, have financial industry affiliations). While 94 of our advisers have more than 1,000 employees, 5204 have 10 or fewer. Information obtained from SEC-registered investment adviser Form ADV filings as of September 9, 2002.

22 "Written" policies and procedures would, of course, include documents in electronic format. See Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery Of Information, Investment Advisers Act Release No. 1562 (May 9, 1996) [61 FR 24643 (May 15, 1996)].

23 See discussion above in Section I of this release.

24 The rule would not preclude an adviser from seeking assistance in collecting and voting proxies from, for example, a proxy voting service. Nor would the rule prevent an adviser from delegating authority to, for example, a committee. The adviser's delegation would not alter in any way the fiduciary responsibilities of the adviser.

25 Procedures that merely declare that all proxies will be voted in the best interests of clients would not be sufficient to meet the requirement of the proposed rule that the investment adviser adopt "policies and procedures" designed to assure that proxies are voted in the best interests of clients.

26 Under ERISA, a person becomes a fiduciary to a plan by rendering it investment advice for a fee or other compensation. Section 3(21)(A)(ii) of ERISA [29 U.S.C. 1002(21)(a)(ii)]. An ERISA fiduciary must discharge its duties solely in the interest of the plan participants and for the exclusive purpose of providing benefits to plan participants with the care, prudence, and diligence that a prudent person would use. Section 404(a)(1) of ERISA [29 U.S.C. 1104(a)(1)].

27 Proposed rule 206(4)-6(b). The requirement to disclose how a client can obtain information from the adviser on how it voted client securities could be satisfied by disclosure in the adviser's brochure. See supra note 11, Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV (proposal to require advisers that have or will accept authority to vote client proxies to include in their brochures a description of their voting policies and procedures, including what means a client can pursue to find out how the adviser voted the client's proxies in particular solicitations).

28 See supra note 2, Disclosure of Proxy Voting Policies and Proxy Voting Records By Registered Management Investment Companies.

29 The advisory contract could, however, limit a client's right to information about how the adviser has voted her proxy. See Restatement (Second) of Agency § 381 ("[u]nless otherwise agreed, an agent is subject to a duty to use reasonable efforts to give his principal information which is relevant to affairs entrusted him . . . "). We believe that a contract that denied information to the client about how the adviser has voted proxies would be highly unusual and, unless initiated by the client, very troublesome in light of an adviser's fiduciary obligations.

30 Proposed rule 206(4)-6(c). The requirement to describe the adviser's policies and procedures could be satisfied by disclosure in the adviser's brochure. See supra note 11, discussing Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV (SEC proposal to require advisers to include this information in their brochure).

31 In 1971, we recommended adoption of a similar requirement because we believed that "[T]his type of public disclosure would focus the obligation of institutions to act in the interests of their beneficiaries and lead to their setting up procedures for systematic attention to questions of stockholder voting . . . the beneficiary should be able to choose the institutional manager whose policies on investment management appear to him most appropriate. The only way in which this can be done is to give beneficiaries full information about the policies followed." Letter from SEC Commissioner Richard B. Smith to Congress, transmitting the Institutional Investor Study Report (March 10, 1971), reprinted in, H.R. Doc No. 92-64, Part 1 (1971).

32 The provisions of section 206 of the Act would be applicable to an investment adviser that disclosed its policies and procedures but then materially deviated from them.

33 Those investment advisers subject to ERISA must already maintain "adequate and accurate" records as to the voting of ERISA plan proxies to permit monitoring by the plan trustee or other named fiduciary. See DOL Interp. Bulletin, supra note 12.

34 Proposed rule 204-2(c)(2).

35 Proposed rule 204-2(e)(1). These are the same retention requirements that apply to most books and records under current rule 204-2.

36 44 U.S.C. 3501 to 3520.

37 See section 210(b) of the Advisers Act [15 U.S.C. 80b-10(b)].

38 See rule 204-2(e) [17 CFR 275.204-2(e)].

39 Based on our records of information submitted to us by investment advisers in Part 1 of Form ADV, 6,203 SEC-registered investment advisers report that they provide continuous and regular supervisory or management services for client securities portfolios on a discretionary basis.

40 This estimate potentially overstates the number of advisers that would be subject to the rule. Part 1 of ADV does not require investment advisers to describe whether they vote proxies on behalf of clients. Nor does Part 1 require advisers to describe whether securities managed by the adviser are voting securities as opposed to, for example, government or other debt obligations for which proxy voting issues never arise.

41 6,203 × 10 = 62,030.

42 In April of 2000, we proposed amendments to Form ADV, Part 2 that would require investment advisers that vote client proxies to describe their proxy voting policies and procedures in their brochure. Electronic Filing by Investment Advisers; Proposed Amendments to Form ADV, Investment Advisers Act Release No. 1862 (April 5, 2000) [65 FR 20524 (April 17, 2000)]. An adviser could satisfy the disclosure requirements under proposed rule 206(4)-6(b) and (c) by describing its policies and procedures in its brochure. See supra notes 27 and 30. In connection with our April 2000 proposal, when we obtained OMB approval for our amendments to the Form ADV collection that would result from the proposed changes to Part 2, we included the paperwork burden of describing any proxy voting policies and procedures in a firm's brochure.

43 See Custody of Funds or Securities of Clients by Investment Advisers, Investment Advisers Act Release No. 2044 (July 18, 2002) [67 FR 48579 (July 25, 2002)].

44 670 × 10% = 67.

45 0.1 × 67 × 6,203 = 41,560. In connection with submitting this collection of information to OMB, the Commission has also prepared an estimate of the aggregate annual cost to affected firms of this annual aggregate hour burden. We anticipate that investment advisers would likely use compliance professionals to document their firms' proxy voting policies and procedures. We estimate the hourly wage for compliance professionals to be $60, including benefits. We anticipate that investment advisers would likely use clerical staff to deliver copies of proxy voting policies in response to clients' requests. We estimate the hourly wage for clerical staff to be $10, including benefits. Accordingly, we estimate the annual aggregate cost of collection to be $4,137,400 ((62,030 hours × $60 per hour) + (41,560 hours × $10 per hour) = $4,137,400).

46 62,030 + 41,560 = 103,590.

47 7,687 × 195.34 = 1,501,578.5.

48 1,582,293 - 1,501,578.5 = 80,714.5.

49 195.34 + 20 = 215.34.

50 20 × 6,203 = 124,060. In connection with submitting this collection of information to OMB, the Commission has also prepared an estimate of the aggregate annual cost to affected firms of this annual aggregate hour burden. We anticipate that investment advisers would likely use compliance clerical staff to maintain the records required under the proposed amendments. We estimate the hourly wage for compliance clerical staff to be $13.20, including benefits. Accordingly, we estimate the annual aggregate cost of collection to be $1,637,592 (124,060 hours × $13.20 per hour = $1,637,592).

51 (1,501,578.5 current hours +124,060 additional hours = 1,625,638.5 aggregate burden hours) / 7,687 SEC-registered investment advisers = 211.48.

52 This estimate is based on information submitted by SEC-registered advisers in Form ADV, Part 1 [17 CFR 279.1]. 6,203 SEC-registered investment advisers reported that they provide continuous and regular supervisory or management services for client securities portfolios on a discretionary basis.

53 Because Part 1 of Form ADV does not require advisers to describe the types of securities for which they hold discretionary investment authority, some of these advisers may only manage securities for which proxy voting issues never arise, such as government or other debt obligations.

54 For example, the firm is a fixed income manager, which does not manage voting equity securities, or the firm does not manage significant client assets.

55 As discussed supra note 45, we anticipate that investment advisers would likely use compliance professionals to document their firms' proxy voting policies and procedures, for an aggregate annual average of 62,030 hours at an average wage and benefit cost of $60 per hour, for an aggregate cost of $3,721,800. We anticipate that investment advisers would likely use clerical staff to deliver copies of proxy voting policies in response to clients' requests, for an aggregate annual average of 41,560 hours at an average wage and benefit cost of $10 per hour, for an aggregate cost of $415,600. As discussed supra note 50, we anticipate that investment advisers would likely use compliance clerical staff to maintain the records required under the proposed amendments, for an aggregate annual average of 124,060 hours at an average wage and benefit cost of $13.20 per hour, for an aggregate cost of $1,637,592. $3,721,800 + $415,600 + $1,637,592 = $5,774,992. For these estimates, we used wage and benefit rates published by the Securities Industry Association. See Securities Industry Association, Report on Management and Professional Earnings in the Securities Industry 2001 (Oct. 2001); Report on Office Salaries in the Securities Industry (Oct. 2001).

56 5 U.S.C. 603(a).

57 17 CFR 275.0-7(a).

58 This estimate is based on the information submitted by SEC-registered advisers in Part 1 of Form ADV. Advisers are not required to describe on Part 1 whether they vote proxies on behalf of their clients. These 138 small advisers report on their Part 1 that they provide continuous and regular supervisory or management services for client securities portfolios on a discretionary basis. For purposes of estimating the number of small advisers that might vote client proxies and thus be subject to the proposal, we will infer that these 138 advisers vote proxies on behalf of one or more clients in connection with providing discretionary asset management services. This estimate potentially overstates the number of small advisers that would actually be subject to the rule. For example, the assets under discretionary management at some of these firms may consist of government or other debt obligations for which proxy voting issues never arise.

59 29 U.S.C. 1001, et. seq.

60 Dept. of Labor, Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Guidelines, 29 CFR 2509.94-2 (2001).

61 Id.

62 An investment manager under ERISA is any plan fiduciary, other than a trustee or named fiduciary, who has the power to manage plan assets, has acknowledged its fiduciary status, and is either an investment adviser (registered with the SEC or the states), bank, or insurance company. Section 3(38) of ERISA [29 U.S.C. 1002(38)].