



The Way You Invest Matters<sup>SM</sup>

November 27, 2001

VIA FEDERAL EXPRESS

Mr. Harvey L. Pitt, Chairman  
United States Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Re: Disclosure of Mutual Fund Proxy Voting

Dear Chairman Pitt:

Two years ago, Domini Social Investments became the first mutual fund manager in America to publish the actual proxy votes we cast for each company in our Funds' portfolios. Our votes are published on our website, [www.domini.com](http://www.domini.com). We also publish on an annual basis comprehensive proxy voting guidelines so that our Funds' shareholders know how we intend to vote their shares on important issues of corporate governance and social and environmental responsibility. On behalf of Domini Social Investments, I am writing to urge the Commission to propose and adopt rules requiring that all mutual funds do the same, as it has become increasingly clear that mandatory (as opposed to voluntary) disclosure is in the best interests of America's mutual fund shareholders.

On two earlier occasions, in 1971 and 1978, the Commission proposed rules mandating disclosure of mutual fund voting policies and practices, but each time withdrew its proposals. As you know, enormous changes have taken place in the mutual fund industry since that time. These changes clearly evidence the need for renewed consideration of proxy voting disclosure and transparency, consistent with the Commission's role of protecting mutual fund investors and maintaining the integrity of the securities markets.

After two decades of rapid growth, mutual funds now account for approximately 22 percent of all US equity shares (and therefore voting power).<sup>1</sup> Whereas in 1980 barely six percent of US households owned mutual funds, by 2000 mutual fund ownership had climbed to almost 50 percent of US households.<sup>2</sup> Many employers have opted to convert defined benefit plans into defined contribution plans where employees allocate their own investments, principally to mutual funds. Institutional investors, who own more than two-thirds of US equity shares, now invest approximately one-third of their assets in

<sup>1</sup> ICI 2001 Mutual Fund Fact Book at 31.

<sup>2</sup> ICI 2001 Fact Book, *supra*, at 44.



mutual funds.<sup>3</sup> As a result of these changes, mutual funds today arguably hold the swing vote when it comes to corporate governance.

Against this backdrop, the Commission has stepped up efforts in recent years to require and encourage the disclosure of meaningful information by mutual funds to their investors. Federal disclosure rules now mandate that mutual funds provide investors detailed information – in plain English – about investment objectives, investment policies, strategies, risks, fees and holdings. Earlier this year, the Commission took a step in the direction of proxy disclosure as well, proposing that registered investment advisers be required to disclose their proxy voting practices on their Form ADV registration statements. In its filing (No. S7-10-00), the Commission stated that it was proposing the rule change “so that [adviser] clients will be fully informed about who is responsible for voting their proxies and how their interests in proxy voting decisions are protected.”

The Commission’s Form ADV proposal stopped short, however, of requiring actual disclosure of proxy votes, and though the provision would benefit the *clients* of investment advisers, including mutual funds, it would not require that mutual funds in turn disclose their proxy voting practices to their own *investors*. There are still no regulatory requirements or even industry guidelines for the disclosure of voting or governance information that would allow mutual fund investors to evaluate how mutual fund managers are discharging their proxy voting duties. In our view, the Commission needs to take this additional step: mutual funds should be required to disclose their proxy voting practices to their shareholders, and to disclose actual proxy votes cast as well.

Today, most mutual funds routinely vote with corporate management.<sup>4</sup> Meanwhile, their shareholders remain in the dark because these votes are not disclosed. Even those mutual funds that take a more careful or activist approach to corporate governance (i.e., sometimes voting against company management if fund management deems it in their shareholders’ interests) – either by voting directly or delegating their voting responsibility to proxy adviser firms – generally do not disclose to their own shareholders either their proxy voting policies (if they have them) or their actual proxy votes.

In a *Washington Post* report earlier this year,<sup>5</sup> representatives of two of the nation’s largest mutual fund companies stated that they do not disclose either their proxy voting guidelines or their actual votes because their investors “have not evidenced any real interest in how we discharge our voting responsibilities [Fidelity].” “People invest in mutual funds because they want professional investment management and someone to vote their proxy [Vanguard].” Interestingly, implicit in each statement is the recognition that voting such proxies is a fiduciary responsibility.

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<sup>3</sup> Id. at 97-98.

<sup>4</sup> Palmiter, Alan R., *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?*, Social Science Research Network Electronic Library, papers.ssrn.com, Draft, May 9, 2001, at 8-9, 16; See also, “Passing the Buck,” *Institutional Investor Magazine*, October 1, 2000.

<sup>5</sup> “Prodding for Disclosure of Funds’ Proxy Votes,” April 8, 2001



The question then surely becomes: if proxy voting is a fiduciary responsibility of fund management, why is disclosure not mandated? I can think of no other instance where the Commission countenances opacity rather than transparency in the discharge of fiduciary obligations. Indeed, when it comes to proxy voting there is not even a record-keeping requirement, let alone a disclosure requirement. I believe it is time to address this anomaly.

The manner in which mutual funds exercise their proxy voting responsibilities should be considered a fundamental indicator of responsible mutual fund governance. We believe that the current approach taken by most mutual fund companies in not disclosing their policies or votes should be considered an abdication of their fiduciary responsibility. To argue that ordinary investors are not “demanding” this information is surely beside the point, and this has never been the sole basis or even a primary reason for disclosure. Indeed, in a great many cases, ordinary investors are simply unaware of what they are missing, and are not therefore in a position to “demand” it. Certainly, ordinary investors were not demanding disclosure of comprehensive risk and standardized performance information, but the Commission nevertheless required such disclosure because it believed that investor education and mutual fund transparency would lead to better mutual fund governance and stronger markets. As you recently remarked yourself, “It is axiomatic that comprehensible information is the lifeblood of strong and vibrant markets.”<sup>6</sup>

At Domini, we do not believe that mutual fund investors “want...someone to vote their proxy” for non-diverse, self-perpetuating boards, excessive CEO compensation or substandard environmental, labor or human rights standards. Nor do we believe that social, environmental and corporate governance issues are unrelated to long-term corporate performance. Proxy voting is the most direct means by which individual investors – either directly or through mutual fund or other financial intermediaries – can play an active role in influencing corporate behavior. It seems to us that the Commission should be encouraging investors to do so – they are, after all, the owners of these corporations.

There is also mounting evidence that progress on social, environmental and corporate governance issues is linked to long-term corporate performance, and increasing numbers of institutional investors actively vote their proxies as a strategy for influencing corporate behavior and enhancing portfolio performance.<sup>7</sup> A study of the CalPERS shareowner process found that engagement with company management, including proxy voting, could yield positive results to a portfolio.<sup>8</sup> Certainly, some mutual fund managers might conclude that fund performance could be enhanced through corporate governance activity as well as through trading activity, or that encouraging improved corporate citizenship on the part of a portfolio company may constitute a more promising strategy than selling its stock entirely. This is particularly true at a time when so many investors are invested in

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<sup>6</sup> Remarks Before the AICPA Governing Council, October 22, 2001.

<sup>7</sup> See Palmiter, A., *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?*, *supra*, at 3, note 1.

<sup>8</sup> Nesbitt, Steven L. “Long-Term Rewards from Shareholder Activism: A Study of the CalPERS Effect,” *Journal of Applied Corporate Finance*, Winter 1994.



index funds, where trading activity is not used as a performance-enhancement strategy and voting/governance activity may constitute an important means of increasing fund value. Disclosure of such activity may be of value not only to investors but to financial intermediaries, ranking agencies and others interested in determining how such shareholder activity might impact company and fund performance.

Moreover, proxy votes on shareholder resolutions have had a measurable impact on corporate behavior – and in the view of many, on corporate and mutual fund performance – over the last decade. For example, shareholder pressure on corporations doing business with the Apartheid regime in South Africa convinced scores of companies (including IBM and Mobil Oil) to change their policies. More recently, shareholders have helped convince Home Depot to stop selling timber harvested from old growth forests and Coca-Cola to increase recycled content in plastic bottles. Numerous companies have agreed to release EEO data, adopt non-discrimination policies toward gay and lesbian employees and improve environmental reporting as a result of proxy votes.

The Commission need not embrace the notion that proxy voting on social, environmental or corporate governance issues positively impacts fund value or corporate financial performance in order to acknowledge that many investors surely believe that it does; and if this is true, that they should be entitled to this information – just as they are entitled to information on mutual fund strategies, risks and fees.

We believe it is time for the Commission to acknowledge what the Department of Labor has acknowledged in the context of private pension funds governed by ERISA – that the proxy is an important asset and should be voted by fund fiduciaries with due regard for shareholders' interests. When investors buy mutual fund shares they are hiring (and paying for) professional management with respect to both investment services *and* voting/governance services. Disclosure with respect to the latter should be considered a fundamental fiduciary obligation that mutual funds owe to their shareholders, and should be required as a matter of law. Certainly, disclosure would promote accountability and transparency, which are not only guiding principles of our financial regulatory system but have been special concerns of the Commission in recent years.

I would urge the Commission to once again take up the work it began in the 1970s, and to build upon the disclosure agenda it has advanced through the Plain English initiative and the Form ADV proposal of earlier this year. In our view, there is simply no justification for the continued opacity of mutual fund voting/governance activity in a regulatory scheme that otherwise embraces and promotes transparency. Nor is there any basis for denying this potentially valuable information to mutual fund shareholders, or for allowing mutual fund managers to proceed unchecked and unaccountable. The required disclosure of proxy voting policies and practices is clearly consistent with the Commission's position on virtually every other mutual fund governance and disclosure issue that I am aware of.

Americans are increasingly cynical about the enormous power of global corporations that seem to be beyond the control of anyone but a small group of inside shareholders and



their hand-picked managers. This is unfortunate, given that so many Americans today own shares of these very same companies, either directly or through financial intermediaries such as mutual funds. There is no reason why small groups of inside shareholders should exercise such control over American corporations at a time when shares are more democratically dispersed than at any time in history. Proxy voting disclosure will provide the information that mutual fund investors need to ensure that their mutual funds are accurately representing their interests when they vote on corporate governance, social and environmental issues. I see no justification for withholding this important information from America's mutual fund investors.

On behalf of Domini Social Investments, I would urge the Commission to propose for adoption a rule requiring all mutual funds to adopt and publish proxy-voting policies and to record and publicly disclose their proxy votes.

Thank you in advance for consideration of this matter.

Sincerely,

Amy Domini

*Founder and Managing Principal*

Cc: Mr. Jonathan Katz, Secretary  
Securities and Exchange Commission  
(Reference: Proposed Rule S7-10-00)