

**MEMO# 24533**

September 9, 2010

# **SEC Adopts Rules Facilitating Shareholder Director Nominations**

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TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 46-10  
ETF ADVISORY COMMITTEE No. 37-10  
INVESTMENT COMPANY DIRECTORS No. 20-10  
SEC RULES MEMBERS No. 88-10  
SMALL FUNDS MEMBERS No. 50-10 RE: SEC ADOPTS RULES FACILITATING SHAREHOLDER DIRECTOR NOMINATIONS

The Securities and Exchange Commission has adopted changes to the federal proxy rules to facilitate shareholders' ability to nominate directors of companies, including investment companies. [\[1\]](#) The rules will be effective sixty days after publication in the Federal Register, except with respect to smaller reporting companies, which will not have to comply with Rule 14a-11 until three years after the effective date. [\[2\]](#) New Rule 14a-11 under the Exchange Act will require companies, in certain circumstances, to include shareholder nominees for director in the companies' proxy materials. Rule 14a-8 under the Exchange Act, as amended, will preclude companies from excluding from their proxy materials shareholder proposals by qualifying shareholders that seek to establish a procedure under a company's governing documents for the inclusion of one or more shareholder director nominees in the companies' proxy materials. [\[3\]](#) The new rule and rule amendments are summarized below.

## **Rule 14a-11**

### **Application of the Rule and Nominating Shareholder Requirements**

Rule 14a-11 will apply to companies that are subject to the SEC's proxy rules (including investment companies). Companies cannot "opt out" of being subject to Rule 14a-11. This means that the proxy access right will apply regardless of whether a company has a

provision in its governing documents providing for, or prohibiting, the inclusion of shareholder nominees in its proxy materials. The only exception to Rule 14a-11's applicability is if state law or a company's governing documents prohibit shareholders from nominating directors. [\[4\]](#)

A shareholder or group of shareholders nominating one or more directors will have to beneficially own, either individually or in the aggregate, at least 3% of the voting power of the company's securities that are entitled to be voted on the election of directors at the meeting and have beneficially owned the securities used to determine the ownership threshold continuously for at least three years (in the case of a shareholder group, each member of the group would have to meet this requirement). In addition, shareholders must provide a statement that they intend to continue to own the required amount of securities through the date of the shareholder meeting and must disclose their intent regarding continued ownership of the securities after the election.

For purposes of the ownership thresholds, only those shares over which the nominating shareholder or group has current voting and investment power may be counted. Borrowed shares and shares that have been sold short may not be included. However, shares loaned to others may be included if the nominating shareholder or group can recall the securities and will recall the securities upon being notified that any of its nominees will be included.

Rule 14a-11 explicitly prohibits a nominating shareholder or group from holding the securities for the purpose of, or with the effect of, changing control of the issuer or to gain more than a limited number of seats on the board. A company will be required to include no more than one shareholder nominee or the number of nominees that represents 25% of the company's board of directors, whichever is greater. Where there are multiple eligible nominating shareholders, the nominating shareholder or group with the highest percentage of the company's voting power will have its nominees included in the company's proxy material. If a shareholder or group of shareholders nominates less than the number of individuals it is entitled to nominate, the company will be required to include the nominees of the shareholder or group with the next highest qualifying ownership percentage, and so on, up to the 25% cap.

Where the term of a director that was nominated pursuant to Rule 14a-11 continues past the meeting date, the director will continue to count for purposes of the cap. If a company decides to nominate an incumbent director who was a shareholder nominee in a prior election, that director will not count toward the 25% cap. In the case of a staggered board, the 25% calculation will be based on the total number of board seats.

## **Shareholder Nominee Requirements**

A company will not be required to include a shareholder nominee in its proxy materials if the nominee's candidacy or, if elected, board membership, would violate controlling state law, federal law, or the rules of a national securities exchange or national securities association (other than exchange or association standards for independence that require a subjective determination). In the case of a registered investment company or business development company, a nominating shareholder or group of shareholders will have to represent that its nominee is not an "interested person" of the company, as defined in Section 2(a)(19) of the Investment Company Act of 1940.

The nominating shareholder or group will be required not to have any agreements with the company with respect to the nomination prior to the submission of Schedule 14N. However, if the company decides to include a shareholder nominee on the company proxy

card as a company nominee, the company can count the nominee toward the 25% cap so long as the company did not have an agreement or enter into negotiations with the shareholder(s) before the shareholder filed its notice on Schedule 14N.

## **Notice and Disclosure Requirements**

To submit a nominee for inclusion in a company's proxy statement and form of proxy, a nominating shareholder or group will have to (1) provide a notice on Schedule 14N to the company of its intent to require the company to include that shareholder's or group's nominee(s) in the company's proxy materials and (2) file the notice with the SEC on the date it is provided to the company.

The notice will have to be provided and filed no earlier than 150 calendar days and no later than 120 calendar days before the date that the company mailed its proxy materials for the prior year's annual meeting (the "window period"). If the company did not hold an annual meeting during the prior year or the date of the meeting has changed by more than 30 calendar days from the prior year, the nominating shareholder will have to provide notice a reasonable time before the company mails its proxy materials. In those circumstances, the company will be required to disclose the date by which the shareholder will have to submit the notice in a Form 8-K filed within four business days after the company determines the anticipated meeting date. [\[5\]](#)

The notice will have to include representations about the nominating shareholder's or group's eligibility to use Rule 14a-11 and disclosure about the nominating shareholder or group and the nominee for director. The notice will have to be amended promptly in the event of any material change, such as the withdrawal of a nominating shareholder or group, or of a director nominee. The notice and any amendments will be subject to the liability provisions of Exchange Act Rule 14a-9.

If a company includes a shareholder nominee in its proxy materials under Rule 14a-11, the company will be required to include in its proxy materials certain disclosures from Schedule 14N similar to the disclosure required in a traditional proxy contest. In addition, among other disclosures, a company will have to include a statement of support for each nominee provided by the nominating shareholder or group (which statement can be no more than 500 words).

## **Application of the Other Proxy Rules to Nominating Shareholder Solicitations**

Written and oral communications made pursuant to Rule 14a-11, which would be considered to be solicitations under the SEC proxy rules, will be exempt from certain disclosure, filing, and other requirements of those rules so long as the shareholder is not holding the company's shares with the purpose or effect of changing control of the company.

## **Amendments to the Election Exclusion in Rule 14a-8**

Rule 14a-8, the shareholder proposal rule, currently allows a company to exclude from its proxy statement a shareholder proposal that relates to a nomination or an election for membership on the company's board of directors or a procedure for such nomination or election. Under the amendments, shareholders will be permitted, under certain circumstances, to require companies to include in company proxy materials proposals that seek to establish a procedure in a company's governing documents for the inclusion of one

or more shareholder director nominees in a company's proxy materials. [\[6\]](#) The Release makes clear that a shareholder proposal submitted under Rule 14a-8 that prevents a shareholder from nominating a director under Rule 14a-11 by, for example, including a higher ownership threshold or longer holding period, will not be permitted. However, proposals that provide additional means for a shareholder to nominate a director (such as by providing a shorter holding period) will be permitted.

New disclosure requirements will apply to a shareholder nomination for director for inclusion in company proxy materials made other than pursuant to proposed Rule 14a-11 (i.e., pursuant to procedures established under state law or by a company's governing documents) that largely mirrors the disclosure required for a nomination under Rule 14a-11. The nominating shareholder or group will be liable for any false or misleading statements in these disclosures pursuant to Rule 14a-9.

The SEC also amended Rule 14a-8(i)(8) codifying certain prior staff interpretations concerning the types of proposals that companies could continue to exclude. In particular, a company would be permitted to exclude a shareholder proposal under Rule 14a-8(i)(8) if it: (i) will disqualify a nominee who is standing for election; (ii) will remove a director from office before his or her term expired; (iii) questions the competence, business judgment, or character of one or more nominees or directors; (iv) seeks to include a specific individual in the company's proxy materials for election to the board of directors; or (v) otherwise could affect the outcome of the upcoming election.

## **Proxy Card Disclosure**

New Rule 14a-4(b)(2)(iv) will require a company that includes a shareholder nominee in its proxy materials to use a "universal" proxy in which each nominee for director is listed on the proxy card. Since there will be more nominees than directorships, the proxy card will only allow shareholders to deliver a proxy for up to the number of seats up for election. While the company will be allowed to indicate for each nominee whether the board recommends a vote "for" the nominee, the company will not be permitted to provide shareholders with the ability to check a box and vote for the entire company-recommended slate.

## **Beneficial Ownership Rule Changes**

The rules will amend Exchange Act Rule 13d-1(b)(1)(i) and (c)(1) to clarify that a shareholder or a group of shareholders will not lose its Schedule 13G reporting eligibility by virtue of engaging in "activities solely in connection with a nomination under Rule 14a-11[.] " The final rules do not, however, exempt members of a nominating group from the requirement to aggregate their holdings and, if required, file under Section 16 of the Exchange Act if they meet Section 16's 10% ownership threshold.

## **Liability of Nominating Shareholders**

Rule 14a-9 will prohibit nominees, nominating shareholders, and nominating shareholder groups from causing to be included in company proxy materials any materially false or misleading statements or omissions. In addition, Rule 14a-11(f) will provide that a company will not be responsible for information that is provided by the nominating shareholder or group under Rule 14a-11 and then repeated by the company in its proxy statement. A company will not be required to recirculate or correct proxy materials if it

learns that the materials provided to shareholders included false or misleading information from the nominating shareholder or group. None of the information provided by a nominating shareholder or group and included in the company's proxy materials will be incorporated by reference into any of the company's SEC filings unless the company specifically incorporates it.

## Effective Date

The effective date (as well as the compliance date) will be 60 days after the date of publication in the Federal Register, except that companies that qualify as "smaller reporting companies" as of the effective date will not be subject to Rule 14a-11 until three years after the effective date. Shareholders seeking to use new Rule 14a-11 during the 2011 proxy season will be able to do so if the window period for submitting nominees (i.e., no earlier than 150 calendar days, and no later than 120 calendar days, before the anniversary of the date the company mailed its proxy materials for the prior year's annual meeting) is open after the effective date of the rules. If the window period opens and closes before the effective date of the new rules, shareholders will not be permitted to submit nominees for inclusion in the company's proxy materials for the 2011 proxy season. In those cases where the window period may open before the effective date of the rules but close after the effective date, shareholders will be able to submit a nominee between the effective date and the close of the window period.

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### endnotes

[1] See Facilitating Shareholder Director Nominations, SEC Release No. 33-9136 (August 25, 2010) ("Release"), available at <http://www.sec.gov/rules/final/2010/33-9136.pdf>.

[2] The term, "smaller reporting companies," as defined in Securities Exchange Act of 1934 Rule 12b-2, explicitly excludes investment companies. See Release at note 176.

[3] Rule 14a-8(i)(8) currently provides that a company need not include in its proxy materials a proposal that "relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election [.]"

[4] The Release states that if a company's governing documents prohibit shareholder nominations, shareholders could seek to amend the provision by submitting a shareholder proposal under Rule 14a-8.

[5] An investment company that is a series company also will have to disclose under Item 5.08 of Form 8-K the total number of shares outstanding and entitled to vote for the election of directors at a meeting of shareholders as of the end of the most recent calendar quarter. Other investment companies will have to disclose this information in their most recent annual or semi-annual reports filed on Form N-CSR.

[6] The requirement in the current rule that a shareholder proponent be required to have continuously held at least \$2,000 in market value, or 1%, of the company's securities entitled to be voted on the proposal at the meeting for a period of at least one year prior to submitting the proposal will remain unchanged. Further, the shareholder proposal will have to meet the procedural requirements of Rule 14a-8, which will remain the same. No new disclosures will be required from a shareholder submitting a proposal to amend, or requesting an amendment to, a company's governing documents.

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