

MEMO# 23560

June 18, 2009

SEC Proposal to Facilitate Shareholder Director Nominations

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TO:

CLOSED-END INVESTMENT COMPANY COMMITTEE No. 10-09
ETF ADVISORY COMMITTEE No. 15-09
SEC RULES COMMITTEE No. 37-09
SMALL FUNDS COMMITTEE No. 9-09

RE:

SEC PROPOSAL TO FACILITATE SHAREHOLDER DIRECTOR NOMINATIONS

The Securities and Exchange Commission has proposed changes to the federal proxy rules to facilitate shareholders' ability to nominate directors of companies, including investment companies.[\[1\]](#) The proposal has two components that would make it easier for shareholders to nominate directors:

1. Proposed new Rule 14a-11 under the Securities Exchange Act of 1934 would require companies, in certain circumstances, to include shareholder nominees for director in the companies' proxy materials.
2. A proposed amendment to Rule 14a-8(i)(8) under the Exchange Act[\[2\]](#) would preclude

companies from excluding from their proxy materials shareholder proposals by qualifying shareholders that would amend, or request an amendment to, a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided the proposal does not conflict with proposed Rule

14a-11.

The proposal is summarized below.

Comments on the proposal are due to the Commission by August 17, 2009. We will hold a conference call on Tuesday, June 30th at 2:00 EDT to discuss the proposal and ICI's comments. The dial in number for the call is (800) 369-2120 and the pass code is 22366. Please email Maureen Maher at mmaher@ici.org if you plan to participate on the call. If you are unable to participate, please provide any comments to Frances Stadler (202/326-5822 or frances@ici.org) or Dorothy Donohue (202/218-3563 or ddonohue@ici.org) before the call.

Proposed Rule 14a-11

Application of the Rule and Nominating Shareholder Requirements

Proposed Rule 14a-11 would apply to companies that are subject to the SEC's proxy rules (including investment companies), unless applicable state law or a company's governing documents prohibit shareholders from nominating board candidates. A shareholder or group of shareholders nominating one or more directors would have to meet certain eligibility requirements, including minimum ownership thresholds that would be tiered based on the size of the company. Specifically, the nominating shareholder or group would have to:

- Beneficially own, either individually or in the aggregate:
 - For large accelerated filers as defined in Exchange Act Rule 12b-2, and registered investment companies with net assets of \$700 million or more, at least 1% of the company's securities that are entitled to be voted on the election of directors at the shareholder meeting;
 - For accelerated filers as defined in Rule 12b-2, and registered investment companies with net assets of \$75 million or more but less than \$700 million, at least 3% of the company's securities that are entitled to be voted on the election

of directors at the meeting;

- For non-accelerated filers as defined in Rule 12b-2, and registered investment companies with net assets of less than \$75 million, at least 5% of the company's securities that are entitled to be voted on the election of directors at the meeting;
- Have beneficially owned the securities used to determine the ownership threshold continuously for at least one year (in the case of a shareholder group, each member of the group would have to meet this requirement); and
- Represent that it intends to continue to own those securities through the date of the shareholder meeting.

For purposes of the ownership thresholds, in determining the securities entitled to be voted on the election of directors for a company other than an investment company, a nominating shareholder or group of shareholders would be able to rely on the company's most recent quarterly or annual report, and any current report subsequent thereto, filed with the SEC, unless the shareholder or shareholder group knows or has reason to know that the information in the report is inaccurate. In the case of an investment company, a nominating shareholder or group of shareholders could rely on the following documents to determine the securities entitled to be voted and the investment company's net assets unless they have reason to know the information contained therein is inaccurate:

- For an investment company other than a series investment company, the most recent annual or semi-annual report filed with the SEC on Form N-CSR (net assets would be the amount of net assets as of the end of the company's second fiscal quarter in the fiscal year immediately preceding the fiscal year of the meeting, as disclosed in Form N-CSR); and
- For a series investment company, a Form 8-K that such a company would be required to file with the SEC disclosing (1) the company's net assets as of June 30 of the calendar year immediately preceding the calendar year of the meeting and (2) the total number of shares outstanding and entitled to be voted (or if the votes are to be cast on a basis other than one vote per share, then the total number of votes entitled to be voted and the basis for allocating such votes) at an annual meeting of shareholders (or special meeting in lieu of an annual meeting) as of the end of the most recent calendar quarter.[\[3\]](#)

To rely on proposed Rule 14a-11 to have disclosure about their nominee included in a company's proxy materials, a nominating shareholder or group could not hold 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.[\[4\]](#) The nominating shareholder or group would be required to provide to the company and file with the SEC a notice on proposed new Schedule 14N containing prescribed information (discussed below).

Shareholder Nominee Requirements

A company would 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 would 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.

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 would 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 would have to be provided and filed by the date specified by the company's advance notice provision or, if no such provision is in place, no later than 120 calendar days before the date that the company mailed its proxy materials for the prior year's annual meeting. 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 must provide notice a reasonable time before the company mails its proxy materials. In those circumstances, the company (including an investment company) would be required to disclose the date by which the shareholder must submit the notice in a Form 8-K filed within four business days after the company determines the anticipated meeting date.

The notice would have to include:

- The name and address of the nominating shareholder or of each member of a shareholder group;
- Information regarding the amount and percentage of securities owned and entitled to be voted at the meeting;
- A written statement from the record holder of the shares (where applicable) verifying

that, as of the date of the notice, the nominating shareholder continuously held the securities for at least one year;

- A written statement of the nominating shareholder's or group's intent to continue to own the requisite shares through the date of the shareholder meeting and the shareholder's or group's intent with respect to continued ownership after the election; and
- A certification that to the best of the nominating shareholder's or group's knowledge, the securities are not held for the purpose of, or with the effect of, changing control of the issuer or gaining more than a limited number of seats on the board.

The notice also would 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. According to the Proposing Release, this information would be similar to the disclosure currently required in a contested election. The notice would 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 would be subject to the liability provisions of Exchange Act Rule 14a-9.

Requirements for Companies that Receive Notices from Nominating Shareholders

The Proposing Release describes the process if a nominating shareholder or group wishes to include a nominee or nominees in a company's proxy materials, including actions required or permitted to be taken by the nominating shareholder(s), the company, and the SEC staff, as well as the associated timeframes.[\[5\]](#) In general, the process would operate as follows:

- By the date set by a company's advance notice provision or, in the absence of such a provision, no later than 120 calendar days before the date the company mailed its proxy materials the prior year, a nominating shareholder or group must provide a notice of its intent and file the notice on Schedule 14N.
- No later than 14 days after receiving the notice, the company must notify the shareholder or group if it determines it may exclude the nominee(s).
- Within 14 calendar days after receiving the company's deficiency notice, the shareholder or group must respond.
- If, after receiving the shareholder's or group's response, the company determines that it still may exclude the nominee(s), no later than 80 days before the company files its definitive proxy materials with the SEC, the company must provide notice of its intent to exclude the nominee(s) and the basis for its determination to the SEC and to the nominating shareholder or group.

- Within 14 days after receiving the company's notice to the SEC, the nominating shareholder or group may submit a response to the company's notice to the SEC.
- As soon as practicable after receiving the company's notice of its intent to exclude a nominee or nominees and the basis for its determination, the SEC staff, at its discretion, may provide an informal statement of its views to the company and the nominating shareholder or group.
- No later than 30 days before filing its definitive proxy statement, the company must provide the nominating shareholder or group with notice of whether it will include or exclude the shareholder's or group's nominee(s).

Application of the Other Proxy Rules to Nominating Shareholder Solicitations

The Proposing Release notes that proposed Rule 14a-11 would permit shareholders to aggregate their holdings to meet the applicable minimum ownership threshold to nominate a director. It states that, accordingly, the SEC anticipates that shareholders would communicate with each other in an effort to form a nominating group. To facilitate use of proposed Rule 14a-11, the SEC is proposing an exemption from the proxy rules for written communications made in connection with forming a group to use the rule. Such communications, which would have to be filed with the SEC no later than the date the material is first published, would be limited to certain prescribed information. Similarly, the proposal would provide an exemption from the proxy rules for solicitations by or on behalf of a nominating shareholder or group in support of a nominee included in a company's proxy statement and form of proxy in accordance with proposed Rule 14a-11, provided certain conditions are met.

Proposed Amendments to the Election Exclusion in Rule 14a-8

As discussed in the Proposing Release, 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.^[6] The SEC is proposing to amend subsection (i)(8) of the rule to enable shareholders, under certain circumstances, to require companies to include in company proxy materials proposals that would amend, or that request an amendment to, a company's governing documents regarding nomination procedures or disclosures related to shareholder nominations, provided the proposal does not conflict with proposed Rule 14a-11 or applicable state law.

A shareholder proponent would 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. A shareholder

proposal could not be subject to any of the other substantive exclusions under that rule. Further, the shareholder proposal would have to meet the procedural requirements of Rule 14a-8, which would remain the same. No new disclosures would be required from a shareholder submitting a proposal to amend, or requesting an amendment to, a company's governing documents.[\[7\]](#)

The SEC is proposing new disclosure requirements, however, that would 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). According to the Proposing Release, the required disclosure about the nominating shareholder or group and their nominee would be similar to what would be required in an election contest. The nominating shareholder or group would be liable for any false or misleading statements in these disclosures pursuant to Rule 14a-9 as proposed to be amended.

The SEC also is proposing to amend Rule 14a-8(i)(8) to codify 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:

- Would disqualify a nominee who is standing for election;
- Would remove a director from office before his or her term expired;
- Questions the competence, business judgment, or character of one or more nominees or directors;
- Nominates a specific individual for election to the board of directors, other than pursuant to Rule 14a-11, an applicable state law provision, or a company's governing documents; or
- Otherwise could affect the outcome of the upcoming election.

Proxy Card Disclosure

The proposed rules would 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 would only allow shareholders to deliver a proxy for up to the number of seats up for election. While the company would be allowed to indicate for each nominee whether the board recommends a vote "for" the nominee, the company would 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 proposal would amend Exchange Act Rule 13d-1(b)(1)(i) to provide that a shareholder or a group of shareholders that owns more than five percent of a class of equity securities of a company registered under Exchange Act Section 12 would be eligible to report on Schedule 13G, rather than Schedule 13D, provided it is formed solely for the purpose of: nominating director(s) pursuant to Rule 14a-11; engaging in soliciting activities in connection with such a nomination; or having that nominee elected as a director. The proposal would 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 ten percent ownership threshold.

Liability of Nominating Shareholders

The proposal would amend Rule 14a-9 under the Exchange Act prohibiting 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, proposed Rule 14a-11(e) would provide that a company would 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, except where the company knows or has reason to know that the information is false or misleading. As proposed, none of the information provided by a nominating shareholder or group and included in the company's proxy materials would be incorporated by reference into any of the company's SEC filings unless the company specifically incorporates it.

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endnotes

[1] See Facilitating Shareholder Director Nominations, SEC Release No. 33-9046 (June 10, 2009) (“Proposing Release”), available at <http://www.sec.gov/rules/proposed/2009/33-9046.pdf>.

[2] 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 [.]”

[3] The Proposing Release states that the SEC believes an 8-K filing is necessary for series companies because a series company may file multiple Form N-CSRs with respect to different series covering different fiscal year and semi-annual period ending dates and is required to disclose net asset and outstanding share information on a series by series basis, rather than for the company as a whole.

[4] Under the proposal, a company would be required to include no more than one shareholder nominee or the number of nominees that represents 25 percent of the company’s board of directors, whichever is greater.

[5] The Proposing Release also presents this information in both a tabular and a graphical format. See Proposing Release at 106-107.

[6] The Proposing Release notes that Rule 14a-8(i)(8) was amended in 2007 to expressly permit the exclusion of a proposal that would result in an immediate election contest or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders’ director nominees in the company’s proxy materials for subsequent meetings.

[7] The Proposing Release indicates that the SEC believes that some shareholders may simply desire to amend or establish the company’s procedure for nominating directors, but may not contemplate nominating any particular individual.