

MEMO# 23668

July 30, 2009

Institute Draft Comment Letter on SEC Proposal to Facilitate Shareholder Director Nominations

[23668]

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TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 14-09
ETF ADVISORY COMMITTEE No. 24-09
SEC RULES COMMITTEE No. 45-09
SMALL FUNDS COMMITTEE No. 14-09 RE: INSTITUTE DRAFT COMMENT LETTER ON SEC PROPOSAL TO FACILITATE SHAREHOLDER DIRECTOR NOMINATIONS

The Institute has prepared the attached draft comment letter on a Securities and Exchange Commission proposal that would facilitate shareholders' ability to nominate directors of companies, including investment companies. [\[1\]](#) The draft letter is summarized below.

Comments on the proposal must be filed with the Securities and Exchange Commission by Monday, August 17th. Please provide your comments as soon as possible but no later than August 10th to Frances Stadler by email (frances@ici.org) or phone at (202) 326-5822.

The draft letter points out that as both shareholders of the companies in which they invest and issuers with their own directors and shareholders, investment companies fully recognize the importance of effective corporate governance and also are cognizant of the need to avoid undue interference with the responsibility of the company's officers and directors to manage the company. The letter states that, accordingly, we have a heightened appreciation for the need to balance these interests when addressing shareholder access to company proxy materials.

The draft letter supports allowing shareholders who meet appropriate eligibility criteria to nominate directors or to submit bylaw amendments concerning director nomination procedures on a public operating company's proxy statement. The draft letter states that with respect to investment companies, the Commission has not given sufficient consideration to whether there is a need for proxy access requirements and, if so, how they should work and therefore investment companies should be excluded from the proposal.

I. Applicability to Operating Companies

A. Eligibility Requirements

Intent of Ownership. The draft letter strongly supports the Commission's approach of limiting access to a company's proxy statement only to shareholders who do not hold or have not acquired shares "for the purpose of or with the effect of changing control of the company or to gain more than a limited number of seats on the board."

Ownership Thresholds. The draft letter recommends higher thresholds than those proposed. *We welcome any feedback on the specific thresholds that we should recommend.*

Holding Period. The draft letter states that the Commission's proposed one-year holding period is the *minimum* necessary to achieve the goal of assuring that the interests of shareholder proponents are aligned with the interests of long-term shareholders, but we recommend that the Commission consider a longer holding period, such as two years, to provide greater assurance that shareholder proponents are committed to the long-term mission of the company.

Maximum Number of Shareholder Nominees. The draft letter strongly recommends permitting no more than one shareholder nominee. It points out that given the novelty of permitting shareholder nominees for directors in a company's proxy materials, it is appropriate to limit the number of nominees to one.

Timing of Submitting Nominees. The draft letter opposes the Commission's proposed "first in" approach and instead recommends permitting the shareholders or groups of shareholders with the most significant stake in the company to put forward its nominee. The letter states that this would be a fairer approach.

Notice and Disclosure Requirements for Shareholder Proponents. The draft letter generally supports the proposed notice and disclosure requirements, and recommends that the purpose sought to be achieved by the nominating shareholders also be disclosed.

B. Requirements for Company that Receives a Notice from Nominating Shareholders

Universal Proxy. The draft letter recommends permitting issuers to provide shareholders with the ability to check a box and vote for the entire company-recommended slate.

Liability. The draft letter strongly supports the Commission expressly providing in rule text that the nominating shareholder would be liable for statements *provided by* the nominating shareholder to the company and included in the company's proxy materials. Consistent with this approach, the letter recommends modifying the proposal to provide that a company would not be responsible for any disclosure in the company's proxy statement *based on* information provided by the nominating shareholder. The letter also recommends modifying the proposal so that the company only would be responsible for false and misleading information provided by a nominating shareholder if the company knows that information is false or misleading, rather than being responsible for information provided by the nominating shareholder that the company "has reason to know" is false and misleading.

II. Proposed Bylaw Amendments under Rule 14a-8

The draft letter recommends higher thresholds and a longer holding period for shareholders who submit bylaw amendments regarding director nomination procedures. *We welcome your feedback on the appropriate threshold and holding period.*

The draft letter supports requiring these shareholder proponents to provide the same disclosure that would be required of shareholders nominating directors on the company's proxy statement.

III. Applicability to Investment Companies

The draft letter recommends excluding investment companies from the pending proxy access rule, and further suggests that the Commission consider whether to craft a new proposal better suited to the unique attributes of investment companies based on economic analysis and other considerations.

Unitary or Cluster Boards. The draft letter points out that the proposal does not adequately account for the most prevalent types of investment company boards – unitary or cluster boards – or for other important differences between investment companies and operating companies. It describes the difficulties and irrational situations that would arise when applying proxy access to funds with unitary or cluster boards.

Impact on Small Fund Advisers. The draft letter describes the importance of small fund advisers and explains the difficulties they will experience if they are no longer able to utilize unitary or cluster boards.

Investment Companies Differ from Operating Companies. The letter points out several distinctions between investment companies and operating companies, including the Investment Company Act's regulation of shareholder voting rights on key decisions. It states that despite these longstanding and widely recognized differences between operating companies and investment companies, the Commission's proposal does not draw any distinction in the application of the fundamental requirements of the proposal. Further, it appears from the Release that the Commission was trying to influence operating company, rather than investment company, board functions in designing the rule proposal. The letter concludes that, given these differences and the mismatch between the Commission's goals and the functions of investment company boards, investment companies should be excluded from any final rule.

Commission's Economic Analysis. The draft letter states that the absence of economic analysis with respect to investment companies provides yet another reason for the Commission to make any final version of the current proposal inapplicable to investment companies. Rather, the Commission first should establish that there is a need for proxy access requirements in the investment company context, and only if so, then develop a tailored proposal and analyze its economic effects on both investment companies generally and small funds in particular.

IV. Other Comments

The draft letter also makes several additional comments including, among other things, supporting requiring shareholders to only nominate directors that are disinterested

directors under Section 2(a)(19) of the Investment Company Act and opposing the proposed requirement that investment companies file Form 8-K.

Dorothy M. Donohue
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[Attachment](#)

endnotes

[1] See [Memorandum](#) to Closed-End Investment Company Committee No. 11-09, ETF Advisory Committee No. 16-09, SEC Rules Committee No. 38-09, and Small Funds Committee No. 10-09 [23572], dated June 22, 2009 (summarizing the proposal).

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