The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

MEMO# 32487

May 28, 2020

SEC Staff Permits Funds to Opt in to State Control Share Acquisition Statutes

[32487]

May 28, 2020 TO: ICI Members
Investment Company Directors SUBJECTS: Closed-End Funds
Compliance RE: SEC Staff Permits Funds to Opt in to State Control Share Acquisition Statutes

On May 27, 2020, the Securities and Exchange Commission's Division of Investment Management issued a statement[1] providing funds with additional anti-takeover defenses by enabling them to opt in to state control share acquisition statutes ("control share statutes"). The statement reverses the SEC staff's previous position that funds opting in to control share statutes are acting inconsistent with the Investment Company Act of 1940.The statement also requests feedback on whether the Commission should take further action in this area.

The staff's actions follow recent ICI advocacy urging the Commission or its staff to permit funds to opt in to state control share statutes and to issue guidance on the defenses that closed-end funds and their independent directors may use to defend against activist campaigns.[2]

This memorandum provides background on control share statutes and summarizes the relief the staff statement provides to funds and its request for feedback.

Background

Several states have corporate laws that allow issuers to opt in to state statutes known as "control share statutes," which restrict the voting power of "controlling" shares (*e.g.* those shares held by a shareholder in excess of 10 percent of the issuer's outstanding shares). This voting restriction on the controlling shareholder limits the shareholder's ability to encourage, or force, an issuer to take certain actions, such as conducting a tender offer, unless the other shareholders agree to restore those rights.

In 2010, the SEC staff issued a letter, *Boulder Total Return Fund, Inc.*, interpreting the Investment Company Act as prohibiting closed-end funds from opting in to state control share statutes.[3] In particular, the *Boulder* letter states, among other things, that restricting a shareholder's right to vote is inconsistent with the Investment Company Act's requirement that all fund shares be voting stock with equal voting rights with every other outstanding voting stock.[4]

Relief

The staff statement withdraws the *Boulder* letter effective immediately, following SEC Chairman Clayton's instruction to review prior staff positions to ascertain whether such positions should be modified, rescinded, or supplemented in light of market or other developments.[5] The staff explains that it is withdrawing the *Boulder* letter following Chairman Clayton's instruction and its review of the *Boulder* letter, market developments since the letter's issuance, and recent feedback from affected market participants.[6]

In the letter's place, the staff provides funds with no-action relief stating that it would not recommend enforcement action against a closed-end fund for opting in to and triggering a control share statute. To rely on the relief, a fund board's decision to opt in must be taken with reasonable care consistent with other applicable duties and laws and the duty to the fund and its shareholders generally. In particular, the staff reminds market participants that any fund board actions taken, including with regard to control share statutes, should be examined in light of (1) the board's fiduciary obligations to the fund, (2) applicable federal and state law provisions, and (3) the particular facts and circumstances surrounding the board's action.

Request for Feedback

The staff also seeks input to determine whether additional Commission action is warranted in the area to, among other things, provide greater certainty to funds and their shareholders. It asks the following questions, requesting data where feasible, to inform any future staff recommendations to the Commission with respect to the application of the Investment Company Act to control share statutes.

1. What are the practical and functional impacts on closed-end funds, their management, and their shareholders when funds opt-in and trigger control share statutes? How are those impacts affected by the availability of other defensive measures? Relatedly, in what circumstances would the availability of other defensive measures affect a fund's decision to opt-in to and trigger a control share statute?

2. What considerations would a fund's board take into account in determining whether to opt-in to and trigger a control share statute, particularly with regard to benefits to shareholders and compliance with the board's fiduciary duty? Under what specific facts and circumstances would a board decide to opt-in to and trigger a control share statute (or decline to do so)?

3. Apart from [Section 18(i) of the Investment Company Act], which turns on the meaning of "equal voting rights," please explain whether the ability to opt-in to and trigger a control share statute would have a practical or functional impact on a fund's compliance with other provisions of the federal securities laws, such as [S]ection 12(d)(1)(E) of the [Investment Company] Act, which requires pass-through or mirror voting for certain fund of funds arrangements, or [R]ule 13d-1 under the Securities Exchange Act of 1934, which places a limitation on the ability of certain shareholders from voting based on the size of their holding. If relevant, please provide an analysis of any practical or functional differences between how the principle of equal voting rights may apply in those different regulatory contexts.

4. Should the staff recommend that the Commission address the ability of a closed-end fund to opt-in and trigger a control share statute in accordance with [S]ection 18(i)?

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endnotes

[1] *See* SEC Division of Investment Management, Control Share Acquisition Statues (May 27, 2020), *available at* https://www.sec.gov/investment/control-share-acquisition-statutes.

[2] *See, e.g.*, ICI, Recommendations Regarding the Availability of Closed-End Fund Takeover Defenses (Mar. 2020), *available at* https://www.ici.org/pdf/20_ltr_cef.pdf.

[3] *See Boulder Total Return Fund, Inc.* (pub. avail. Nov. 15, 2010) ("Boulder"), *available at* https://www.sec.gov/divisions/investment/noaction/2010/bouldertotalreturn111510.htm.

[4] *See, e.g.*, Section 18(i) of the Investment Company Act.

[5] *See* SEC Chairman Jay Clayton, Statement Regarding SEC Staff Views (Sept. 13, 2018) (stating that staff statements are non-binding and distinct from Commission rules and regulations), *available at* https://www.sec.gov/news/public-statement/statement-clayton-091318.

[6] In particular, the staff notes that the number of listed closed-end funds has declined considerably since the issuance of the *Boulder* letter, although it notes that it is unclear to what extent the unavailability of control share statutes under the *Boulder* letter may have contributed to the trend. *See, e.g.*, ICI, 2019 Investment Company Fact Book, at Chapter 5 (showing that the number of closed-end funds has declined by more than 20 percent from 2011 through 2018), *available at* https://www.icifactbook.org. The staff also cites to related comments the Commission received on its proposed rule on fund-of-funds arrangements. *See, e.g.,* Comments on Proposed Rule: Fund of Funds Arrangements, Investment Company Act Release No. 33329; File No. S7-27-18, *available at* https://www.sec.gov/comments/s7-27-18/s72718.htm.