The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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INSTITUTE LETTER ON PROPOSED AMENDMENTS TO SHAREHOLDER PROPOSAL RULES

* See Memorandum to Closed-End Investment Company Committee No. 36-97, SEC Rules Committee No. 97-97, dated September 30, 1997. [9557] December 30, 1997 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 51-97 SEC RULES COMMITTEE No. 122-97 RE: INSTITUTE LETTER ON PROPOSED AMENDMENTS TO SHAREHOLDER PROPOSAL RULES _____ As we previously advised you, the Securities and Exchange Commission recently proposed amendments to the rules governing shareholder proposals.* Attached is a copy of the Institutes comment letter on the proposal. The Institutes more significant comments are summarized below. The letter criticizes certain recent staff interpretations of Rule 14a-8s exceptions for ordinary business operations and for moot proposals issued in the context of shareholder proposals involving closed-end investment companies. The letter asks the Commission to correct these staff interpretations. First, the letter recommends that the Commission reconsider the position taken in a no- action letter issued to Clemente Global Growth Fund (pub. avail. Feb. 14, 1997). In that letter, the staff took the position under Rule 14a-8(c)(7), the ordinary business operations exception, that a closed-end fund could not exclude from its proxy statement a shareholder proposal requesting that the board consider soliciting competitive proposals for a new investment adviser. The Institutes letter points out that the staffs position is at odds with the underlying policy of the ordinary business exception to confine the resolution of ordinary business matters to management. The letter further points out that the staff position is especially inappropriate in the context of investment companies, where the Investment Company Act of 1940 establishes an elaborate scheme of corporate governance that specifically charges fund directors with responsibility for evaluating and approving annually the advisers contract with the fund. Second, the letter recommends that the Commission treat an investment companys decision to repurchase fund securities as part of a funds ordinary business operations, which would require reconsideration of a no-action letter issued to The Growth Fund of Spain (pub. avail. March 15, 1996). The Institutes letter states that this would be the most appropriate treatment of fund repurchases of securities, and it would be consistent with the Division of Corporation Finances treatment of repurchases of securities by other issuers. Third, the letter recommends that the Commission reconsider the position taken in a no-action letter issued to New Age Media Fund (pub. avail. Jan. 17, 1997). In that letter, the Commission staff took the position that a fund could not exclude a shareholder proposal recommending that the board of directors "expedite the process" of considering alternative ways to ensure that the funds shares could be purchased and sold at net asset value. The staff rejected the funds argument that the proposal was moot even though the board had

considered the fact that the funds shares traded at a discount on a number of occasions and had specifically considered converting the fund to an open-end fund, on the grounds that it had not specifically considered "expediting the process" or merging the fund with an existing open- end fund. The Institutes letter argues that this application of the mootness exception is overly and inappropriately narrow. It puts funds to the unjustifiable expense of including shareholder proposals that have been "substantially considered or substantially implemented" by the company and it is inconsistent with the Commissions and the Division of Corporation Finances most recent interpretations of the mootness exception. The letter requests the Commission to reconsider the position taken in this letter and to apply the mootness exception to any matter that has been "substantially implemented" by the board or "substantially considered" by the board within a reasonable period of time of a related shareholder proposal. The letter strongly opposes the proposed override mechanism. It points out that it is costly and inappropriate to permit a 3% shareholder to override an ordinary business decision made by a companys directors. In the case of closed-end funds, in particular, it is not uncommon for a single shareholder to hold in excess of 3% of the funds outstanding shares. The proposed override mechanism would permit such a shareholder to put a proposal on the funds proxy statement concerning any ordinary business matter, presumably even a change in a funds investment in specific securities. The letter points out that this would have extraordinarily far-reaching consequences. Not only would it be extremely disruptive to fund operations, but also it would be inconsistent with the reasonable expectations of fund investors. The letter suggests that if the Commission ultimately decides to adopt an override mechanism, it should revise the proposal to ensure that it applies only in cases where there truly is broad based support for the proposal. Therefore, proponents should be required to gather the support of at least 500 shareholders. The letter strongly supports the Commissions proposed increase in the resubmission thresholds but recommends that the thresholds be expressed as a percentage of the votes required to pass the proposal rather than as a percentage of the votes cast, as proposed. The letter points out that the recommended standard would provide a more meaningful indication that a proposal is relevant to a sufficiently significant portion of the shareholder base to warrant repeated submissions of proposals focusing on substantially the same matter. The letter recommends that if the Commission decides to retain the "votes cast" standard, the resubmission thresholds should be increased to 15%, 25%, and 35%, respectively. Dorothy M. Donohue Associate Counsel Attachment (in .pdf format)
