INVESTMENT COMPANY INSTITUTE®

1401 H Street, NW, Washington, DC 20005-2148, USA
202-326-5800 www.ici.org

Susan M. Olson
GENERAL COUNSEL

202-326-5813
susan.olson@ici.org

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Ms. Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Re-Opening of Comment Period for Universal Proxy (File No. S7-24-16)

Dear Ms. Countryman:

The Investment Company Institute[1] supports the Securities and Exchange Commission ("SEC" or "Commission") requiring operating companies and dissidents to use universal proxy cards in contested director elections.[2] Doing so would allow shareholders to vote by proxy for any combination of candidates for the board of directors, as they could if they attended the shareholder meeting in person. We also support excluding registered investment companies and business development companies from any new universal proxy requirements because the associated burdens would greatly outweigh any benefits. The corporate governance structures of funds differ from those of operating companies, and there are important additional protections for fund shareholders under the Investment Company Act of 1940.[3]

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[1] The Investment Company Institute ("ICI") is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts ("UITs") in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$30.8 trillion in the United States, serving more than 100 million US shareholders, and US$9.7 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

[2] *See* Reopening of the Comment Period for Universal Proxy, Sec. Exch. Act Rel. No. 91603 (Apr. 16, 2021) ("Re-Opening Release"), *available at* www.sec.gov/rules/proposed/2021/34-91603.pdf. *See also* Universal Proxy, Sec. Exch. Act Rel. No. 79164 (Oct. 26, 2016) ("2016 Proposal"), *available at* www.sec.gov/rules/proposed/2016/34-79164.pdf.

[3] *See* Letter from Dorothy M. Donohue, Deputy General Counsel, Investment Company Institute, to Brent J. Fields, Secretary, SEC, dated Dec. 19, 2016 ("2016 ICI Letter"), *available at* www.sec.gov/comments/s7-24-16/s72416-1431117-129844.pdf. This letter refers to business development companies as "BDCs," and registered investment companies and BDCs collectively as "funds."

In April, the Commission re-opened the 2016 Proposal's comment period, citing some fund-specific developments since 2016, including that contested elections of directors for closed-end funds[4] had been more common; increased interest in closed-end fund governing documents requiring that directors be elected by a majority of all shares outstanding (rather than of shares voted); and the renewed ability for closed-end funds to opt into state control share statutes.[5]

Many of the contested elections the Commission cites were initiated by activist investors. In 2020, ICI submitted an analysis of these hostile campaigns whereby activists pursue a self-interested agenda to extract short-term profits at the expense of long-term shareholders.[6] In response, some closed-end funds have affirmatively taken steps to protect long-term shareholder interests. These actions reflect the intense pressures closed-end funds and their long-term shareholders face from activists and in fact *support* the Commission excluding all funds from the universal proxy requirements.

In 2019 and 2020, ICI participated in a Universal Proxy Working Group consisting of a broad array of market participants. The Working Group's written submission (of which ICI was a signatory) broadly supported the Commission's 2016 Proposal while signaling openness to certain modifications (*e.g.*, requiring that dissidents instead solicit holders of shares representing more than a bare majority of outstanding voting power).[7] Notably and importantly, the Working Group agreed that excluding funds from the proposal's scope was appropriate.[8]

Our letter focuses on post-2016 developments. The first part reiterates our support for universal proxy requirements on behalf of funds as investors in operating companies. The later parts explain why we continue to urge the Commission to not apply the universal proxy requirements to any funds, including closed-end funds. Where possible, we have included updated data to respond to the Commission's questions and requests for information.

I. ICI Supports Requiring Operating Companies to Use Universal Proxies in Contested Director Elections

Funds are both issuers (and as such they conduct their own proxy campaigns) and shareholders in their portfolio companies. On behalf of funds as investors, we continue to support the 2016 Proposal. In general, a mandatory universal proxy for operating companies would serve the public interest by

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[4] Unless otherwise noted, the term "closed-end fund" includes BDCs, which are a form of closed-end fund that are subject to many of the same requirements as registered closed-end funds.

[5] *See infra* note 50 and accompanying text, for a discussion of state control share statutes.

[6] For a detailed description and analysis of increasing activist attacks and their impact on long-term closed-end fund shareholders, see ICI Recommendations Regarding the Availability of Closed-End Fund Takeover Defenses (March 2020) ("ICI 2020 CEF Report"), *available at* www.ici.org/system/files/attachments/20_ltr_cef.pdf.

[7] *See* Letter from Universal Proxy Working Group to William Hinman, Director of the Division of Corporation Finance, SEC, dated August 6, 2020, *available at* www.sec.gov/comments/s7-24-16/s72416-8347728-228998.pdf.

[8] *Id.* at n.1

providing all shareholders the same voting options, whether they vote by proxy or in person. Permitting funds to vote more easily for a mix of both management and dissident nominees would provide them with a new valuable corporate governance tool. Funds occasionally vote for dissident nominees, and in some cases split their votes between competing slates of nominees. Funds may see value in adding one or more alternative voices to an operating company's board, while not supporting all dissident nominees and still supporting one or more management nominees.[9]

II. ICI Supports Excluding All Funds From Universal Proxy Requirements

In the 2016 ICI letter, we strongly supported the Commission's determination to exclude funds from the universal proxy requirements given their unique attributes. In particular, we highlighted four significant differences between funds and operating companies:

- fund shareholders would not benefit from split-ticket voting because (i) most funds are highly unlikely to have contested elections, or (ii) for the small number of funds that might have contested elections (*e.g.*, exchange-listed closed-end funds), choices between dissident and issuer nominees are binary as a practical matter, meaning that shareholders supporting the fund likely would vote for the issuer's slate *in full* and shareholders sympathetic to a dissident likely would vote for the dissident's slate in *full* (by contrast, operating company shareholders are much more likely to choose a mix of both issuer and dissident nominees);[10]

- funds are subject to the Investment Company Act that supplements other laws and offers additional protections for shareholders, giving them voices in key determinations or constraining or prescribing a fund's activities, diminishing the need for shareholders to have access to universal proxies;

- funds have unique governance structures that would be disrupted by split-ticket voting resulting in a split board; and

- funds typically have different shareholder bases than operating companies that impose higher solicitation costs on them.

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[9] *See, e.g.*, Justin Baer, Dawn Lim and Cara Lombardo, *Investors Give Exxon Payback for Frustrations on Strategy and Climate,* Wall Street Journal (May 28, 2021) (noting that several institutional investors voted for some, but not all, of the dissident's nominees), *available at* www.wsj.com/articles/investors-give-exxon-payback-for-frustrations-on-strategy-and-climate-11622227480. While the SEC's "short slate rule" (Rule 14a-4(d)(4) under the Securities Exchange Act of 1934, which permits a dissident seeking to elect a minority of the board to "round out its slate" by soliciting proxy authority to vote for some registrant nominees on the dissident's card) improves shareholders' voting options in contested director elections, the Commission has correctly noted that "it does not provide [shareholders] the opportunity to choose among all registrant and dissident nominees." *See* 2016 Proposal at 15.

[10] *Id.*

The developments cited in the Re-Opening Release affect none of these observations. Each of these significant and notable differences between funds and operating companies remain unchanged, and the costs of applying universal proxy requirements to funds greatly outweigh any potential benefits. Below, we analyze the differences in the context of today's market environment. In addition, we explain why, if the Commission were to conclude differently and apply the universal proxy requirements to funds, we strongly urge that dissident shareholders be required to solicit a much higher percentage than a bare majority of the shares entitled to vote on the election of directors. This is a critical safeguard for long-term fund shareholders.

A. Split-Ticket Voting Would Not Benefit Fund Shareholders

i. Most Funds Rarely Have Contested Elections And Closed-End Fund Contested Elections Present Binary Decisions

Split-ticket voting would not benefit fund shareholders. The vast majority of funds (*i.e.*, mutual funds, ETFs, and unlisted closed-end funds (*e.g.*, interval funds and tender offer funds)) do not have annual meetings, very rarely have contested director elections, and are transacted at net asset value ("NAV").[11] Without annual meetings, these funds hold director elections infrequently. In addition, because shares of these funds are transacted at or near NAV and there is no opportunity for dissidents to profit from eliminating a "discount," dissidents have had little incentive to nominate their own directors or otherwise influence the management of the funds, and have very rarely engaged in any proxy contests.[12]

Likewise, split-ticket voting would not benefit exchange-listed closed-end fund shareholders. Although it is common for dissidents to nominate directors as part of a series of actions aimed at creating a liquidity event,[13] the dissident's nominees continue to represent a binary choice for shareholders, *i.e.,* to vote with fund management or against it. Unlike the nuanced decisions that shareholders may make for operating company directors, where they may favor some, but not all, changes to a board's makeup, fund shareholders who prefer the fund to liquidate partially or entirely likely will vote for the entire dissident's slate to maximize the probability that the dissident's nominees will prevail and exact a

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[11] While ETF shares are not necessarily traded at NAV by shareholders on exchanges, they generally trade at or near their NAV because authorized purchasers and other market participants may purchase and redeem their shares at NAV and engage in arbitrage activities that keep market prices at or close to NAV. At the end of 2020, mutual funds and ETFs accounted for approximately 96 percent of all registered investment companies and more than 99 percent of all registered investment company assets under management (exclusive of UITs, which do not have boards of directors and, consequently, would not have contested director elections that are the subject of the proposal). *See* ICI, 2021 Investment Company Fact Book (2021) ("ICI 2021 Fact Book") at 40-41, *available at* www.icifactbook.org.

[12] As the SEC highlights, there have been no proxy contests in any open-end funds since 2000. In addition, we are unaware of any proxy contests in any ETF or unlisted closed-end fund.

[13] Between 2016 and 2020, nearly two-thirds of contested proxy solicitation filings included a slate of dissident-recommended director nominees. Data are calculated based on publicly available filings in the SEC's EDGAR database. *See also infra* at text surrounding notes 47-48.

liquidity event. Conversely, fund shareholders that support maintaining the nature of their closed-end fund investment likely will vote entirely for management's slate. In fact, we are unaware of any closed-end fund proxy contests that resulted in a "mixed-board" outcome in which only some but not all of a dissident's nominees won a board seat. With such a stark choice between management and dissident nominees, there is no need to apply universal proxy requirements to closed-end funds.

ii. Funds' Activities Are Limited and Subject to the Investment Company Act

As described in our 2016 ICI Letter, split-ticket voting likewise is less meaningful for fund shareholders because funds, unlike operating companies, are subject to the Investment Company Act in addition to the other applicable securities laws and regulations. Funds primarily invest in securities (as contemplated and defined under the Investment Company Act) and do not engage in the multitude of activities and businesses that operating companies may engage in. The Investment Company Act accordingly imposes strict and specifically calibrated requirements on a fund's activities, such as requiring shareholders to approve certain key changes (*e.g.*, approving new investment advisers and material changes to investment advisory contracts) or requiring funds to disclose how they will approach certain types of key investment activities.[14] Funds also have extensive and fulsome requirements related to disclosure. These provisions bind a fund to its described practices and its prescribed legal requirements and limit the discretion of the fund's investment adviser. Further, as the Commission describes, the Investment Company Act specifically minimizes conflicts of interest and requires funds to disclose their financial condition and investment policies to investors.[15] The Act has provisions and rules that focus on fund structure and operations for the benefit and protection of shareholders, ensuring robust public disclosure about funds and their investments and their investment strategies, policies, and objectives. These special protections impose substantive requirements that are not imposed on operating companies or available to their shareholders.[16] These Investment Company Act provisions uniquely give fund shareholders a voice on specific key decisions or constrain a fund's or management's activities, diminishing the need for shareholders to have access to universal proxies.

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[14] *See*, *e.g.*, Section 15(a) of the Investment Company Act (requiring fund shareholders to approve new investment advisers and material changes to a fund's investment advisory contracts); and Section 8 of the Investment Company Act (requiring funds to describe fundamental investment policies and how the fund will approach certain specified activities, such as borrowing money, investing in senior securities (*e.g.*, derivatives), concentrating investments in particular industries or groups of industries, investing in real estate and commodities, etc.).

[15] *See* SEC, *The Laws that Govern the Securities Industry* (June 2021), *available at* www.sec.gov/answers/about-lawsshtml.html#invcoact1940.

[16] *See also* Andrew J. Donohue, Director of the Division of Investment Management, SEC, *Speech: Investment Company Act of 1940: Regulatory Gap between Paradigm and Reality?*, *available at* www.sec.gov/news/speech/2009/spch041709ajd.htm ("The [Investment Company Act] includes substantive protections beyond the disclosure requirements, including the safekeeping and proper valuation of fund assets, restrictions on transactions among affiliates, and governance requirements. Moreover, the [Investment Company] Act limits the amount of leverage that funds may bear . . . .").

B. Split-Ticket Voting Would Increase Fund Costs

i. Funds Have Unique Governance Structures

Split-ticket voting also could lead to disruptions to well-established and efficient fund governance structures that would impose unnecessary and higher costs on fund shareholders. Fund complexes have unique governance structures that differ from those of traditional operating companies in which one board is responsible for overseeing only that company's operations. As was the case in 2016, virtually all funds continue to employ a "unitary board" structure in which a single board oversees all of the funds in the complex, or a "cluster board" structure in which more than one board each oversees a designated group of funds in the complex. According to a 2019 ICI and Independent Directors Council study representing 92 percent of the industry's total assets, 89 percent of participating fund complexes employ the unitary board structure, while the remaining 11 percent employ a cluster board structure.[17] Based on data from that study, for participating complexes with at least one closed-end fund, 80 percent employ a unitary board structure with all other funds in a complex, and 20 percent employ a cluster board.[18]

There are a number of valuable benefits to these structures. They improve board efficiency and enhance board knowledge of complex-wide fund operations and regulations. Complex-wide fund operations tend to be quite similar, and funds in a complex typically share key service providers, including a common investment adviser, principal underwriter, transfer agent, administrator, custodian, fund counsel, fund auditor, insurance carrier, and pricing service(s). Because of these commonalities, contracts, policies, and practices within a fund family are fairly uniform. Unitary and cluster boards leverage this uniformity for the benefit of shareholders, allowing fund directors to gain greater familiarity with a complex and how aspects of its operations might impact one or more funds in the complex. They also permit fund boards to have greater access to, and influence over, the funds' investment adviser than if they represented fewer funds in the complex. Because they are negotiating on behalf of multiple funds, unitary and cluster boards may have a greater ability than single-fund boards to negotiate with management over matters such as fund expenses, allocation of resources, and compliance and audit functions.

Likewise, unitary and cluster boards enable funds and fund directors to efficiently meet their common regulatory obligations under the Investment Company Act. Fund directors, for example, must: review and approve a fund's investment advisory contract, compliance policies and procedures, and codes of ethics; oversee the fair valuation of fund portfolio securities; review and approve an open-end fund's

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[17] *See* ICI and Independent Directors Council, Overview of Fund Governance Practices, 1994–2018 (Oct. 2019), *available at* www.idc.org/system/files/attachments/19_pub_fund_governance.pdf. The number and makeup of the clusters may be determined by several factors, including the type of funds (*e.g.*, closed-end funds) or whether the funds in a particular cluster were acquired by the complex as a group.

[18] *Id.* We understand that, for efficiency, a number of fund complexes that have closed-end funds and employ a cluster board structure share the same board as all of the complex's other closed-end funds.

liquidity risk management program; oversee fund brokerage, soft dollar arrangements, and trade allocations; and review and approve plans for allocating common expenses among funds in the same complex. Unitary or cluster boards ensure consistency that greatly enhances both board efficiency and shareholder protection, as there is less likelihood for compliance errors under common board-approved procedures.

The structures also permit boards to oversee multiple funds with tremendous efficiency. As a result of their many responsibilities, board meetings are lengthy and require review of, often times, voluminous and complex materials that cover multiple funds. The unitary and cluster board structures enable concurrent board meetings, combined board materials, and reduced meeting fees and other expenses. In addition, fund management can avoid having to make multiple presentations. Thus, these structures reduce costs and improve efficiencies for funds and their shareholders.

A split-ticket election that results in one or more dissident directors joining a fund board would eliminate these efficiencies. Funds with unitary or cluster boards would be forced to make costly and disruptive changes to accommodate that board.[19] Combined meetings and board materials would no longer be possible, as dissident nominees would have to leave during discussions pertaining to other funds, and customized board materials would have to be provided for each board.[20] Additionally, funds would have to change the logistics of board meetings. Management and others would be forced to make repetitive presentations for additional boards. Split-ticket voting, consequently, could lead funds to experience additional administrative complexities and redundancies, generating additional and unneeded shareholder costs.[21]

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[19] A dissident joining a fund board also may raise compliance issues for funds. Section 10(a) of the Investment Company Act requires at least 40 percent of a fund's board to consist of independent directors. In addition, the SEC has conditioned several of its commonly-used exemptive rules on fund boards having a majority of independent directors. A dissident nominee could be deemed to be an "interested person" under Section 2(a)(19) of the Investment Company Act (*e.g.*, if he or she owned 5 percent or more of a fund's shares) and, therefore, would not qualify as an independent director of the fund. Accordingly, it is possible that the nomination and election of a dissident nominee who is an interested person of the fund would cause a fund to fail to meet the required percentage of independent directors necessary to operate or to rely on certain exemptive rules.

[20] We understand that, in other similar contexts, the SEC staff has raised the possibility of using confidentiality agreements to preserve the unitary and/or cluster structure if a third-party (*e.g.*, a dissident director) were to receive confidential information about a fund. There are a number of practical and legal impediments to such an approach. *See* Letter from Paul Stevens, President and CEO, ICI, and Michael S. Scofield, Chair, Governing Council, Independent Directors Council, to The Honorable Mary L. Schapiro, Chairman, SEC, et al., dated April 7, 2010 (attaching a Memorandum to ICI and Independent Directors Council from Eric F. Fess and Felice Foundos, Chapman and Cutler LLP Regarding Use of Confidentiality Agreements for Non-Conforming Directors (Feb. 24, 2010) (analyzing the effectiveness of confidentiality agreements)), *available at* www.sec.gov/comments/s7-10-09/s71009-649.pdf.

[21] Although the Commission has observed that many recent proxy contests have involved a dissident that contests elections for multiple closed-end funds in the same complex, we have found only one instance in which an activist's nominees have sought positions on *all* funds of a closed-end fund's complex or cluster. *See* Schedule 14A's (dated May 25, 2017) for the

The effectiveness of split-ticket voting is further limited for closed-end funds, as many closed-end funds have "staggered board" or "classified board" terms in which only a minority of the board's directors stand for election at any one time.[22] According to a survey submitted in December 2019, 88 percent of participants' closed-end funds have adopted staggered board policies, consistent with state law.[23] This structure, fully consistent with state law, increases the chances of the types of costly disruptions described above without any meaningful changes for shareholders.

In short, the heavy costs of these disruptions are simply not justified or fairly balanced by the minimal and mostly theoretical benefits to fund shareholders of the universal proxy card.[24]

ii. Funds Have Different Shareholder Bases Than Operating Companies

Consistent with the 2016 ICI Letter, funds continue to have largely retail shareholder bases that will cause them to incur greater solicitation costs from contested elections than operating companies. Retail investors held approximately 89 percent of US mutual fund total net assets at year-end 2020.[25] Similarly, our members indicate that retail investors hold the vast majority of closed-end fund shares. In contrast, retail investors hold approximately 31 percent of the aggregate value of operating companies' publicly traded stock.[26]

Since 2016, ICI has written extensively about the unique challenges that funds face in conducting their proxy campaigns.[27] Proxy campaigns are often more challenging for funds due to:

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three closed-end funds owned by Clough Global Closed-End Funds, one of which is *available at* www.sec.gov/Archives/edgar/data/0001350869/000090266417002478/p17-1243defc14a.htm. The activists' targeted attacks of certain, but not all, funds in a complex or cluster certainly will lead to the splintering of fund boards, eviscerating many of the efficiencies and cost savings these funds gain from unitary and cluster boards.

[22] Classified boards provide stability and promote continuity in seeking a fund's long-term stated investment objective that is aligned with the expectations of the fund's investors, while also protecting against abrupt changes. They ensure that that the board has prior experience and assist with succession planning, allowing the fund adequate time to plan orderly changes to its board and giving new directors the opportunity to gain knowledge from experienced directors.

[23] *See* ICI 2020 CEF Report, *supra* note 6, at Figure A.6.

[24] *See* Section II.A. The Commission asks to what extent disclosure to shareholders in the proxy materials regarding such potential losses in efficiency would be sufficient to mitigate the risk of such disruptive outcomes. *See* Re-Opening Release, *supra* note 2, at Q. 14. Such disclosure could inform investors who choose to read it, but we question why the Commission would change the current approach for funds if the outcome results in little to no meaningful benefit to shareholders.

[25] *See* ICI 2021 Fact Book, *supra* note 11, at 68.

[26] ICI's estimate of retail holdings of operating companies is based on data from *Financial Accounts of the United States* (published by the Federal Reserve Board) (Mar. 2021).

[27] *See, e.g.,* Analysis of Fund Proxy Campaigns: 2012–2019 (December 2019), *available at* www.sec.gov/comments/4-725/4725-6580709-201124.pdf; Letter from Paul Schott Stevens, President and CEO, ICI, to Vanessa Countryman, Acting Secretary, SEC, dated June 11, 2019, *available at* www.sec.gov/comments/4-725/4725-5658296-185774.pdf.

- Funds' diffuse and retail-oriented shareholder bases;
- Retail shareholders' relatively low proxy voting participation rates; and
- Severe legal and other impediments to communicating directly with fund shareholders.

Funds, therefore, typically must engage proxy solicitors at great expense to their shareholders to locate, contact, and solicit proxies for any matter that is deemed to be non-routine, such as a contested election. A 2019 ICI survey distributed to ICI members on closed-end funds illustrates how much closed-ends funds can spend on contested matters. While routine matters for survey participants cost closed-end funds an average of $22,000, contested matters cost closed-end funds an average of $623,000.[28] Applying the universal proxy requirements to funds could encourage dissidents to rely on a fund's solicitation efforts, as further described below, and lead to more frequent contested director elections, thereby greatly increasing the solicitation costs for funds and their shareholders.

C. If Universal Proxy Requirements Were Applied To Funds, Dissidents Must Have Higher Minimum Solicitation Requirements

For the reasons above, the SEC should exclude all funds from the universal proxy requirements. If, however, the SEC were to include any funds, including closed-end funds, within the scope of the requirements, the SEC should at a minimum require dissidents to solicit at least 75 percent of the shares entitled to vote on the election of fund directors.[29] Although most funds are held mainly by retail investors, activist investors at times could acquire significant holdings in closed-end fund shares that are noticeably higher than what typically is seen in connection with activist campaigns at operating companies.[30] In more than 26 percent of activist campaigns and almost 25 percent of the proxy contests held in 2020, the activist investor that brought the campaign beneficially owned more than 20 percent of the fund's shares.[31] Given that activist investors sometimes work in packs to exert influence, a

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[28] *See* ICI 2020 CEF Report, *supra* note 6, at Figure A.7.

[29] *Cf.* Letter from the Universal Proxy Working Group, *supra* note 7, at 2 (stating that "the majority of the [Working Group] participants believe that requiring the solicitation of holders of two-thirds of outstanding voting power could also be workable, while commanding broader comfort that the threshold strikes an appropriate balance between providing the utility of the universal proxy system and precluding dissidents from capitalizing on the inclusion of dissident nominees on the registrant's card without undertaking meaningful solicitation efforts").

[30] *See* Morgan, Lewis & Bockius LLP, White Paper: Shareholder Activism at SEC Registered Closed-End Investment Funds in the Wake of Covid-19 ("Morgan Lewis White Paper") at 7-8, *available at* www.morganlewis.com/-/media/files/publication/morgan-lewis-title/white-paper/2020/capital-markets-white-paper-shareholder-activism-at-closed-end-funds.pdf.

[31] *Id.* (citing data from FactSet Research, Inc.).

minimum solicitation of a bare majority of the fund's share entitled to vote could be met fairly easily by soliciting only a few beneficial owners, including the dissidents themselves.[32]

Without a meaningful minimum solicitation requirement, a mandatory universal proxy requirement will enable dissidents to list their nominees on a fund issuer's proxy card and capitalize on the fund's required efforts without spending much of their own time, money, or effort to solicit sufficient support for their nominees to win board seats. Thus, a bare majority solicitation requirement will serve to enable dissidents to have very little of their own "skin in the game." This would be patently unfair and not serve the interests of long-term shareholders.

III. Additional Reasons Why the Commission Should Not Apply the Requirements to Closed-End Funds

Applying universal proxy requirements to closed-end funds will encourage more activist activity to the detriment of long-term fund shareholders. Even if minimum solicitation requirements are imposed on activists, the universal proxy requirements undoubtedly will make it easier for them to execute their strategy to create liquidity events and to seek and obtain board seats to induce these events. It allows activists to shift the costs of engaging in such behaviors to funds and their shareholders, capitalizing on fund solicitation efforts and largely relieving activists of the time and expense it takes to solicit proxies. This is far from fair to long-term shareholders of the fund. There are many benefits to the closed-end structure sought by investors in these funds.[33] This fund structure can provide investors with income and exposure to a more diversified pool of assets (*e.g.*, less liquid assets compared to assets in an open-end fund), while providing professional investment management with a strong governance framework and comprehensive regulation under the Investment Company Act (as well as regulatory oversight by

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[32] This dynamic has led some closed-end funds to adopt higher thresholds for shareholders to approve specified actions, consistent with state laws (*e.g.*, a majority of all outstanding voting shares rather than just a majority of the shares voted). *See infra* text preceding note 50.

[33] *See infra* note 45. Policymakers have recognized the potential benefits of using registered closed-end funds to provide access to the private markets. *See* Dalia O. Blass, Director of the Division of Investment Management, *Speech: PLI Investment Management Institute* (July 28, 2020) ("Closed-end funds can provide another and different pathway [to provide access to private investments]. They do not offer daily redemptions and, therefore, can have more substantial holdings in longer-term, illiquid private investments without having to manage the same risks to liquidity and daily valuation."), *available at* www.sec.gov/news/speech/blass-speech-pli-investment-management-institute. More recently, the SEC's Asset Management Advisory Committee explored ways to increase access to the private markets, including through registered closed-end funds. *See, e.g.*, *SEC Issues Agenda for March 19 Meeting of the Asset Management Committee*, *available at* www.sec.gov/news/press-release/2021-47 (including an agenda item for the Committee's Private Investments Subcommittee to discuss potential recommendations). Last fall, Congressman Anthony Gonzalez (R-OH) introduced a bill that, among other things, would eliminate restrictions on closed-end fund investments in private funds and impose protections against activist investors. *See* Increasing Investor Opportunities Act, H.R. 8786, 116th Cong. (2019–20), *available at* www.congress.gov/bill/116th-congress/house-bill/8786/text/ih?overview=closed&format=txt.

the Commission).[34] To serve long-term investors in those products, the Commission should provide closed-end funds with *more* protections against short-term profiteers and not erode these protections and benefits.

These issues have intensified in recent years, with a small group of activists initiating more frequent campaigns against closed-end funds[35] seeking to capture profits that take advantage of the funds' unique characteristics and transparency. Activists target traditional, exchange-listed closed-end funds because those funds, unlike operating companies, (i) must strike and publish NAVs periodically,[36] and (ii) list and trade on the secondary market with their share prices determined by market supply and demand. Activists target closed-end funds with share prices trading at a "discount" to the fund's NAV by first purchasing a large number of shares at prices below NAV. They then use their concentrated voting power to try to force the fund to take actions that will allow the activists to sell their shares at prices at or near NAV—thereby capturing an arbitrage profit.[37] Although many academics have studied closed-end fund discounts closely, the exact causes of, and ways to solve for, such discounts have not been identified with any certainty. As of May 31, 2021, exchange-listed closed-end funds had an average discount of 2.4 percent of the fund's NAV.

The prevalence of discounts makes exchange-listed closed-end funds an easy target for activist shareholders, and the number of closed-end fund activist campaigns has increased markedly over the

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[34] In addition to protections under the Securities Act of 1933, the Investment Company Act subjects funds to comprehensive requirements. For example, the Investment Company Act, among other things, provides important safeguards requiring funds to: confine their use of leverage; restrict their transactions with affiliates; custody their assets with qualified custodians; diversify their holdings under certain conditions; retain fidelity bonds for their officers and employees to protect against larceny and embezzlement; obtain annual audits of their financial statements from independent accountants registered with the Public Company Accounting Oversight Board; and maintain certain books and records.

[35] *See, e.g.*, ICI 2020 CEF Report, *supra* note 6, at 10 (showing that 89 percent of activist campaigns in 2017 and 2019 came from only five activist investors).

[36] More than 95 percent of closed-end funds calculate the value of their portfolios every business day, while others calculate their portfolio values weekly or on some other basis. *See* ICI, A Guide to Closed-End Funds (2021), *available at* www.ici.org/cef/background/bro_g2_ce.

[37] To highlight this point, we understand that in some cases activists will hedge the investment risk of the closed-end fund holdings, so the swing in the closed-end fund's market price is the activist's only investment exposure. *See, e.g.*, Schedule 13D from Saba Capital Management, LP ("Saba Capital") (Oct. 30, 2020), *available at* www.sec.gov/Archives/edgar/data/1258623/000106299320005267/sched13d.htm ("[Saba Capital] may in the future take such actions with respect to their investment in [a closed-end fund] as they deem appropriate, including, without limitation . . . engaging in short selling of or any hedging or similar transactions with respect to the [shares of the closed-end fund] and/or otherwise changing their intention with respect to any and all matters referred to in Item 4 of Schedule 13D.").

past 25 years, including during the most recent five-year period ended 2020.[38] In 2020, there were 40 new activist shareholder campaigns.[39] Some experts have cited the increased market volatility during March 2020 as one potential reason for increased activism.[40] During that month, average closed-end fund discounts reached nearly 22 percent, providing "attractive opportunities" for activists to acquire large positions in closed-end funds that they later can exploit.[41] In addition, there recently have been a number of fund sponsor mergers resulting in changes of control at certain investment advisers.[42] When this occurs, the Investment Company Act requires each fund in a complex that the acquired asset manager advises to seek and obtain shareholder approval of a new investment advisory contract.[43]

Leveraging these opportunities, activists ultimately seek a liquidity event from the fund that will enable them to realize profits. The liquidity events could occur in the form of:

- a liquidation of the fund, resulting in all shareholders receiving a cash distribution equal to NAV for all shares;

- a conversion of the fund from a closed-end fund to an open-end fund or merger into an open-end fund, resulting in all shareholders having the option to redeem their shares at NAV; or

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[38] *See* James Duvall, "The Closed-End Fund Market, 2020," *ICI Research Perspective* 27, no. 5 (May 2021) ("2021 ICI Research Perspective"), *available at* www.ici.org/files/2021/per27-05.pdf, at Figure 2. For purposes of these statistics, "activist campaigns" were measured by counting the number of publicly filed beneficial ownership (Schedule 13D) and contested proxy solicitation (Schedule 14A) submissions relating to exchange-listed closed-end funds. Some filings downloaded from the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system were deleted from the final data set, including: Schedule 13D filings by certain banks with no formal intent; Schedule 13D filings that appeared simply to be amendments to a previously filed Schedule 13D; Schedule 13D or PREC14A filings by affiliated persons; duplicate Schedule 13D or PREC14A filings made on the same day; and Schedule 13D and PREC14A filings that were duplicates of each other (*i.e.*, their intent was assumed to be the same). Data may include a small number of Schedule 13D filings where shareholders did not disclose an activist intent. The number of activist shareholder campaigns may not reflect the true extent of recent activism, because there may be a number of campaigns from activist shareholders who own less than 5 percent of a closed-end fund's shares and, accordingly, were not required to provide public disclosures about those campaigns.

[39] In particular, there were 40 beneficial ownership (Schedule 13D) and contested proxy solicitation (Schedule 14A) filings in 2020, which is the largest number of these filings since 2010. The number of filings was spread across 35 distinct funds (or over 7 percent of the number of exchange-listed closed-end funds), and 93 percent of these filings were submitted by just three activist shareholders. Calculations are based on the underlying data in the 2021 ICI Research Perspective, *supra* note 38.

[40] *See, e.g.*, Morgan Lewis White Paper, *supra* note 30, at 3.

[41] *Id.* at 3.

[42] *See, e.g., Message from CEO Jennifer Johnson re: Franklin Templeton's Acquisition of Legg Mason*, *available at* www.franklintempleton.com/investor/our-firm/delivering-better-outcomes; *Morgan Stanley Closes Acquisition of Eaton Vance*, *available at* www.morganstanley.com/press-releases/morgan-stanley-closes-acquisition-of-eaton-vance.

[43] *See* Section 15(a) of the Investment Company Act.

- a tender offer by the fund to repurchase up to a specified percentage of the fund's outstanding shares, at a price at or near NAV, resulting in (i) tendering shareholders capturing the higher price on the repurchase shares; and (ii) a potential short-term increase in the market price of the remaining outstanding shares.

Each of these liquidity events risks imposing a significant negative impact on a fund's investment performance and fundamental character—to the detriment of the fund's long-term shareholders.[44] Liquidations and conversions eliminate a shareholder's choice of investment and force fundamental changes to the products that are contrary to what many shareholders sought when making their investments.[45] A completed tender offer reduces a fund's net assets, which can be used to pay a fund's fixed costs, thereby increasing ongoing annual expenses for remaining long-term shareholders.[46]

Recently, activists have employed other complementary strategies as part of the larger strategy to capture arbitrage profits. In addition to seeking liquidity events, activists recently have nominated directors affiliated with or favored by the activist to, at a minimum, make a liquidity event more likely or to take voting control of the board and effectively force such actions to the detriment of long-term shareholders. In many cases, the activist will nominate directors in pursuit of a settlement with the fund resulting in some liquidity event.[47] In rarer cases, absent a settlement, an activist may proceed with seeking board seats in an effort to force a liquidity event or fundamental changes to the investment that shareholders initially made, such as replacing the fund's investment adviser with an activist affiliate or making material changes to the fund's investment strategy, through board action alone (with the help of activist-nominated directors) rather than shareholder approval.[48] It is important that the Commission

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[44] *See* ICI 2020 CEF Report, *supra* note 6 (illustrating the negative impact of these strategies on a fund's investment performance and fundamental character).

[45] Many long-term shareholders generally have not invested in closed-end funds to realize the difference between the NAV and the market price, but have invested based on the funds' investment objectives and strategies, which the closed-end fund structure itself facilitates. Among these vehicle-specific reasons are a desire to receive higher or more sustainable distributions than otherwise might be available, to invest in a vehicle that is more efficiently invested given that it does not need to meet daily redemptions, and to invest in a fund that can assume a greater amount of leverage. If shareholders want NAV-based returns, then there are other options, like mutual funds, that offer such returns.

[46] For a detailed description of the impact that activist-induced tender offers could have on closed-end funds, see ICI 2020 CEF Report, *supra* note 6, at Appendix C; Figures C.5, C.6, C.8 and C.13. *See also* Letter from Susan Olson, General Counsel, ICI, to Ms. Dalia O. Blass, Director, Division of Investment Management, SEC, dated December 16, 2020, *available at* www.sec.gov/divisions/investment/control-share-statutes/investment-company-institute-121620.pdf.

[47] Based on information from a proxy solicitation firm, in calendar year 2020, the majority of closed-end fund proxy contests that the service covered resulted in the dissident withdrawing the proposal or settling with the fund (4 out of 7 contests). *See also* Morgan Lewis White Paper, *supra* note 30, at 10-11 (explaining that closed-end fund activists are less concerned about causing a fund to implement board, investment advisory, and governance changes if they can cause a liquidity event).

[48] For example, in July 2020, Saba Capital prevailed in a proxy contest that saw eight of its nominated directors elected to the board of the Voya Prime Trust. In March 2021, the fund announced that the board selected Saba Capital to serve as the

consider the harm that can be posed by these activists and the purposes of the Investment Company Act.[49]

Regardless of whether a closed-end fund director is independent or deemed to be an "interested person" under Section 2(a)(19) of the Investment Company Act, and/or by whom a director is nominated, all closed-end fund directors owe the same fiduciary duty to the fund—not just to certain shareholders. Accordingly, a director who is affiliated with an activist or who disproportionately favors the interests of an activist shareholder to the detriment of other shareholders may be at great risk of breaching his or her fiduciary duty than other directors. To the extent an activist shareholder encourages or incentivizes a director to breach his or her fiduciary duty, the activist's actions may be even more detrimental to closed-end fund shareholders than when the activist simply attempts to achieve certain goals (*e.g.*, a liquidity event) via shareholder actions alone. In this instance, the activist may even be subject to legal liability.

Funds typically implement defenses consistent with the Investment Company Act and state law to protect long-term shareholders. For example, some funds have changed their organizational documents to require that contested elections be approved by a majority (or other specified portion) of all outstanding voting shares rather than just a majority of the shares voted, consistent with state laws. This defense elevates the shareholder approval requirements for both activist and issuer nominees. After the Commission staff withdrew the *Boulder* letter, some funds have opted into state control share statutes

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fund's new investment adviser upon shareholder approval. In announcing the selection, the fund's press release noted that "[w]hile maintaining the [fund's] primary credit focus . . . the [fund] may depart from its investment strategy and may for example hold a larger cash position . . . [and Saba Capital] plans to transition a meaningful portion of the Fund's portfolio from leveraged loans into investments that [Saba Capital] believes can provide more attractive risk-adjusted returns, including: bonds, special purpose acquisition companies (SPACs) and other ***registered closed-end funds*** . . ." (emphasis added). *See* Schedule 14A from Voya Prime Rate Trust, dated Mar. 25, 2021, *available at* www.sec.gov/Archives/edgar/data/0000826020/000119312521094718/d154783ddefa14a.htm. Following that announcement, Saba Capital announced that the fund will commence a cash tender offer for up to 30 percent of the fund's outstanding shares and the implementation of a managed distribution plan, whereby the fund will make monthly distributions to shareholders at an annual minimum fixed rate. *See* Schedule TO from Voya Prime Rate Trust, dated May 25, 2021, *available at* www.sec.gov/Archives/edgar/data/826020/000168386321003731/f9143d1.htm.

[49] *See* ICI 2020 CEF Report, *supra* note 6, at 26-29 (describing the Investment Company Act and Congressional concerns with self-interested conduct, including by "outside" affiliated persons)

or amended their by-laws to add provisions that mirror state control share statutes,[50] an action intended to protect the interests of a fund and its long-term shareholders.[51]

Recommendations from proxy advisory firms also can substantially boost activist campaigns. Many institutional investors that hold significant positions in closed-end funds retain the services of proxy firms to advise them on how to vote proxies. As the Commission has noted, proxy advisory firms "have become uniquely situated in today's market to influence" institutional investors' voting decisions.[52] Certain of these proxy advisory firms have adopted policies for closed-end fund solicitations to:

> . . . vote against or withhold from nominating/governance committee members (or other directors on a case-by-case basis) at [closed-end funds] that have not provided a compelling rationale for opting-in to a Control Share Acquisition statute, nor submitted a by-law amendment to a shareholder vote.[53]

The policy to date, and to our knowledge, has always resulted in a recommendation against or to withhold votes on director nominees who serve on the nominating or governance committee of a closed-end fund that has opted into a control share statute or adopted by-law provisions mirroring state control share statutes since last May (when the *Boulder* letter was withdrawn). Because of this rigid application of "one-size-fits-all" policies,[54] these director nominees can expect a potentially large

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[50] *See* Division of Investment Management, Staff Statement on Control Share Acquisition Statutes (May 27, 2020) (withdrawing the staff's *Boulder* letter), *available at* www.sec.gov/investment/control-share-acquisition-statutes. In the *Boulder* letter, the SEC staff interpreted the Investment Company Act to prohibit closed-end funds from opting into state control share statutes. *See Boulder Total Return Fund, Inc.* (pub. avail. Nov. 15, 2010), *available at* www.sec.gov/divisions/investment/noaction/2010/bouldertotalreturn111510.htm. State control share statutes restrict the ability of "controlling" shareholders (*e.g.*, those that control more than 10 percent of an issuer's voting securities) from voting their controlling shares, unless the remaining shareholders approve restoring those rights.

[51] In at least several cases, adoption of these defenses has been followed by costly litigation, some of which is ongoing. *See, e.g., Saba Capital CEF Opportunities 1 Ltd. v. Nuveen Floating Rate Income Fund*, No. 1:21-cv-00327, (S.D.N.Y.); *Eaton Vance Senior Income Trust v. Saba Capital Master Fund, Ltd.*, No. 2084-cv-01533 (Mass. Sup. Ct.).

[52] Exemptions from the Proxy Rules for Proxy Voting Advice, Sec. Exch. Act Rel. No. 89372 (July 22, 2020)("Proxy Advice Amendments Adopting Release"), at 8, *available at* www.sec.gov/rules/final/2020/34-89372.pdf.

[53] *See, e.g.,* Institutional Shareholder Services, United States Proxy Voting Guidelines Benchmark Policy Recommendations (Effective for Meetings on or after February 1, 2021) ("ISS Guidelines") at 68, *available at* www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf. ISS's proxy voting policies state that these are its *general* recommendations and are subject to a "compelling rationale," but we are unaware of any instance in which it has recommended voting for such a director nominee.

[54] *See., e.g.*, Proxy Advice Amendments Adopting Release, *supra* note 52, at n.439 and accompanying text (noting that some commenters "believed that proxy voting advice businesses do not adequately adjust their methodologies to take into account the unique circumstances of different companies and therefore more transparent disclosure of methodologies would help investors discern the extent to which voting advice may be based on a 'one-size-fits-all' approach").

portion of shares to either vote against them or to withhold their votes the next time they are up for election.[55]

Activists know this and have taken advantage of these set proxy advisory firm policies, computing the combined holdings of their allies and the institutional investors likely to follow these voting policies to fairly easily predict instances in which their director nominees can secure a victory.[56] These preset proxy advisory firm recommendations hurt director nominees and fail to draw meaningful distinctions between the use of such defenses for closed-end funds and operating companies. They also fail to consider the frequency and negative impacts that activist arbitrage efforts have on the interest of long-term closed-end fund investors.

These developments have placed major strains on closed-end funds, and the number of closed-end funds has steadily declined and total assets have stagnated.

- Since year-end 2007, the number of exchange-listed closed-end funds has decreased by 26 percent (from 658 to 484 funds at year-end 2020).[57]
- Between year-end 2007 and year-end 2020, total assets of exchange-listed closed-end funds declined from $309 billion to $279 billion. By comparison, total net assets of long-term mutual funds and ETFs more than doubled, rising from $9.5 trillion to $25.0 trillion.[58]
- On average, 37 exchange-listed closed-end funds launched each year between 2001 and 2010 compared with an average of 14 launches each year between 2011 and 2020.[59]

These are troubling statistics. Activists—who have inappropriately targeted closed-end funds—have been one reason for the decline in the number of closed-end funds.

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[55] Similarly, certain of these proxy advisory firms have set voting policies stating that their general recommendation for all issuers is to "vote against proposals to classify (stagger) the board" and "vote for proposals to repeal classified boards and to elect all directors annually." *See, e.g.*, ISS Guidelines, *supra* note 53, at 18. ISS's proxy voting policies on staggered and classified boards also state that they are only *general* recommendations, but we are unaware of any instance in which ISS has recommended voting against declassifying a closed-end fund board. In addition, ISS penalizes director nominees that serve on boards implementing such governance structures. One policy, for example, states that ISS will generally vote against director nominees "if the directors . . . [c]lassified the board." *See id.* at 14.

[56] Section 13 of the Securities Exchange Act requires any person or group of persons who directly or indirectly acquires or has beneficial ownership of more than 5 percent of a class of a fund's securities to report this beneficial ownership by filing a Schedule 13D or 13G with the Commission. We understand that activists do not always report their beneficial ownership holdings in a timely or complete manner, so they may have an additional advantage over funds in predicting the outcome of an election.

[57] Data are based on statistics compiled by ICI. Data exclude BDCs.

[58] *Id.*

[59] *Id.*

The closed-end fund is a valuable vehicle for retail investors, specifically designated as a form of investment company in the Investment Company Act and designed to accommodate the different investment strategies and operations of the fund form. As such, the Commission should find ways to support this fund type and ensure retail investors retain this choice in the market.

For all these reasons, we urge the Commission to not apply the universal proxy requirements to closed-end funds, or investment companies more broadly.

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ICI and its members appreciate the opportunity to share our views once again on the Commission's universal proxy proposal. If you have any questions or require further information, please contact me, Dorothy Donohue, Deputy General Counsel (202-218-3563), Kenneth Fang, Associate General Counsel (202-371-5430), or Matthew Thornton, Associate General Counsel (202-371-5406).

Sincerely,

/s/ Susan M. Olson

Susan M. Olson
General Counsel

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee
The Honorable Caroline A. Crenshaw

Sarah G. ten Siethoff, Division of Investment Management
John Coates, Division of Corporation Finance