# ICI Webinar on Proxy Materials

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## Speakers

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# Today's Agenda

- When a Shareholder Vote is Required
- Preliminary Proxy Materials
- General Proxy Statement Requirements – Schedule 14A
- Definitive Proxy Materials
- Shareholder Proposals
- Mergers/Reorganizations
- E-Proxy Rules
- SEC's Concept Release on the U.S. Proxy System

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# Rules

- § 20(a) of the 1940 Act and Rule 20a-1 thereunder
- Regulation 14A under the 1934 Act (Rules 14a-1 through 14a-16 and Rules 14b-1 through 14b-2)
- Schedule 14A
- New York Stock Exchange (NYSE or Exchange) Listed Company Manual Sections 401 and 402 and any other applicable Exchange requirements (*e.g.,* NYSE Arca Equities Rules for ETFs which often trade on NYSE Arca)

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## *Practice Notes*

- While Schedule 14A under the Securities Exchange Act of 1934 is the principal source for the disclosures required in a proxy statement, note that Schedule 14A cross-references to other rules or forms that must be consulted. For example, Regulations S-K and S-X (particularly with respect to Item 9 of Schedule 14A).
- Be careful to read each item of Schedule 14A to see if it is applicable. Not all of the items apply to registered investment companies. For example:
  - Items 7, 8 and 14 explicitly redirect registered investment companies to other items or forms in lieu of these items
  - Item 24, newly added Shareholder Approval of Executive Compensation, also has been interpreted by the SEC Staff not to apply to registered investment companies

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## When Shareholder Vote Required

- Annual meetings – generally only closed-end funds that are exchange traded (see applicable Exchange requirements)
- Special meetings
  - Director/Trustee election
  - Management fee increase
  - Approval of new advisory contract (*e.g.*, assignments/change of control)
  - Amendment of fundamental investment objectives/fundamental policies

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## Procedure for Preliminary Materials

- Notify financial intermediaries, if any, of shareholder meeting and record dates at least 20 business days in advance of the record date (Rule 14a-13) (so called "broker search cards")
- File preliminary proxy materials with the SEC at least 10 calendar days prior to the date on which the proxy statement is to be mailed so the SEC may make comments (Rule 14a-6)
- In addition, for funds whose shares are listed on the NYSE, immediately notify the NYSE of the setting of a shareholder meeting date at least 10 days prior to the record date (Section 401.02)

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## *Practice Notes*

- When preparing a time line for a proxy solicitation campaign, consider whether additional time may be warranted for any one or more elements of the process.
  - For example, with respect to broker search cards, while Rule 14a-13 requires 20 business days prior to the record date, if impracticable, a later date may be used. Also, with the broker search cards, the fund will ask the financial intermediaries how many copies of the materials they will need. The number of copies needed may impact the print schedule.
  - Consider whether the fund's SEC examiner will need or want more than 10 days to review the materials. Depending upon the complexity and/or length of the proxy statement, some funds may choose to call their examiner in advance of the filing.
  - Also consider contacting the fund's SEC examiner if the shareholders will be asked to vote on a sensitive matter, e.g., a lapsed investment management agreement or Rule 12b-1 plan.
- If a fund is also listed on the NYSE and if rights or privileges of listed securities will be substantially affected or new issues or series of listed securities will be created, preliminary materials may be confidentially submitted to the Exchange for review to avoid actions or conflicts (Section 402.02)

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## Preliminary Proxy Statement

- Under Rule 14a-6(a), preliminary proxy materials must be filed unless the proxy solicitation relates only to certain limited matters, including:
  - Director elections
  - An election, approval or ratification of accountants
  - A Rule 14a-8 shareholder proposal
  - A continuance of an advisory or other contract previously the subject of a solicitation
  - An increase in the number of authorized shares

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## *Practice Notes*

- There are many good reasons not to file preliminary proxy materials with the SEC if not required to per Rule 14a-6(a):
  - Save time of the SEC review
  - Avoid unnecessary work for the fund's SEC examiner
  - Save expenses

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## Preliminary Dates

- *Record Date* – governed by state law and fund charter documents
- *Mail Date* – as far away from the meeting date as permitted but as close to the record date as possible to permit a longer solicitation window
  - Example: Maryland corporations must give notice of a shareholder meeting not less than 10 days nor more than 90 days before the meeting
  - Note: If the proxy material will be mailed less than 20 business days prior to the shareholder meeting, any information that would be incorporated by reference must be included in the mailing
  - Consider whether one or more adjournments might be needed

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## General Proxy Statement Requirements – Schedule 14A

- Place/date/time of shareholder meeting; date proxy materials first sent or given; costs of solicitation; record date
- Disclose number of record date shares
- Disclose votes required for each matter (except for auditors)
- Disclose what constitutes a quorum
- Disclose how the votes will be counted
  - Abstentions
  - Broker non-votes

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## General Proxy Statement Requirements (cont'd)

- Disclose the revocability of proxies
- Disclose consequences if the matter is not approved
- Summary table – if the proposal affects more than one fund/class
- Annual report disclosure – annual report is available without charge

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## *Practice Notes*

- Broker non-votes are shares held by brokers or nominees as to which (i) instructions have not been received from beneficial owners or persons entitled to vote and (ii) the broker or nominee does not vote (*e.g.,* does not have discretionary voting power on a particular matter).
  - The effect of abstentions and broker non-votes will vary from state to state and may be impacted by a fund's charter documents.
- Typically, more and more fund shares are held by brokers and other financial intermediaries on behalf of their customers. The right to vote rests with the record owner. Therefore, if a shareholder wants to vote in person at the meeting or change a vote, he or she will need to work through their financial intermediary to receive a "legal proxy" or to revoke previous voting instructions.

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# Please answer the following Polling Question



## Director Elections

- § 16(a) of the 1940 Act
  - At least 2/3 of the fund's board of directors must be elected by the shareholders, otherwise no vacancies may be filled by appointment without shareholder approval
  - If less than 1/2 of the board is elected, the fund must hold a shareholder meeting within 60 days to elect
  - Rule 10e-1 extends the time to fill vacancies to 90 days if vacancy can be filled by appointment; 150 days if shareholder vote required

## Director Elections

- Required Disclosure Regarding Directors, Officers and Significant Shareholders
  - Whether directors are interested or not
    - Many disclosures to be provided separately for interested and disinterested directors
  - Conflicts of interest – directors, nominees and immediate family members
    - Positions (director, officer, employee, etc.)
    - Principal occupations during the past 5 years
    - Certain interests, transactions or relationships (generally, if greater than $120,000)

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## Director Elections

- Board/committee structure
  - Identify committees, their responsibilities, functions, membership and number of meetings held
  - Note total number of meetings and directors who attended less than 75% of those meetings
  - Additional disclosures needed for closed-end funds: compliance with Section 16 of the 1934 Act (S-K Item 405); exemption from listing standards for audit committees (Item 22(b)(14)); and certain audit committee information (charter, independence under applicable listing standards and the audit committee report on the annual financial statements) (Item 22(b)(16))
  - Board leadership structure and role in risk oversight (new requirement)

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## *Practice Notes*

- Typically mutual funds prepare and distribute annually directors' and officers' questionnaires. This information is used in connection with the annual N-1A registration statement update. Many funds also elicit the information through such questionnaires necessary to complete a proxy statement.
  - When preparing a proxy statement, consider whether the information in a D&O questionnaire needs to be "brought down" or made current.
- Some funds use inside counsel to prepare the proxy solicitation materials; other funds rely on outside counsel. Personnel other than attorneys will also likely need to participate in the preparation of the materials.

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## Director Elections

- Material legal proceedings, including those relevant to director's ability to serve
- Other background information on directors, including specific experience, qualifications, attributes or skills that led to the conclusion that such person should serve as a director

- Compensation and retirement benefits
  - Compensation from the fund for the last fiscal year
  - Total compensation from the fund complex
  - Retirement benefits accrued during the last fiscal year and estimated benefits upon retirement

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## Director Elections

- Dollar ownership range of securities of fund and all funds overseen by the director in the complex
- Names of executive officers
- Names of significant shareholders holding at least 5% of outstanding shares as of the most recent practicable date
- Disclose the nominating committee's policy regarding nominating directors
- Disclose purchases or sales of securities of the adviser or its parent
- Disclose fund policy on directors' attendance at annual shareholder meetings, including number that attended prior annual meeting

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## Director Elections

- Disclose information regarding independent public accountants and the audit committee
  - Fees paid by the fund and investment adviser and controlled affiliates (that provide ongoing services to fund) for the last two fiscal years: (See also Form N-CSR.)
    - Audit and audit-related fees
    - Tax fees
    - Any other fees
  - Whether the audit committee has considered whether payment of the above fees is consistent with maintaining the accountants' independence
  - Audit committee's pre-approval policies, if any
  - Audit committee member independence

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## Investment Advisory Contract

- § 15(a) of the 1940 Act
- Important required disclosure (Schedule 14A, Item 22(c))
  - Existing agreement (date, date of last approval, description of terms and fees for the last fiscal year)
  - If there will be a change in the fee, include:
    - the aggregate dollar amount of the fee during the last year;
    - the amount that the adviser would have received had the proposed fee been in effect (pro forma) and a pro forma fee table;
    - the difference between the two amounts as a percentage of the aggregate amount of the fee during the last year.
  - Identify funds with similar investment objective, including size of fund, fee and waiver arrangements
  - Purchases or sales of securities of the adviser by any director or director nominee (Item 22(a)(3)(v))

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## Investment Advisory Contract (cont.)

- Discuss material factors the board considered in recommending shareholder approval
  - This language may not be boiler-plate
  - Language must reflect a weighing of factors
- Disclose brokerage commissions paid to affiliates
- Disclose fees paid to adviser and affiliates for non-advisory services

- Include "form of" new agreement as exhibit to the proxy statement and discuss all material differences

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## Rule 12b-1 Plan

- Required if proposing a new Rule 12b-1 plan or material increase in amounts to be spent under an existing 12b-1 plan
- Important required disclosure (Schedule 14A, Item 22(d))
  - Existing plan (date, who receives payments under the plan, amount of fees paid, description of the terms and any action taking by the board regarding the plan in the last fiscal year)
  - Material differences between the old and new plan
  - Discuss material factors the board considered in making the change
    - This language may not be boiler-plate
    - Change must be for the benefit of the fund and its shareholders
  - If there will be a new or higher fee, include a fee table

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## Amendment to Fundamental Policies

- § 13 of the 1940 Act
- Include a description of the changed policy
- Generally, present each policy as a separate proposal
- Discuss why the change is being recommended and is in the interests of the fund and its shareholders
- Focus on how the policy changes the risk to which shareholders are exposed

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## Ratification of Accountants

- § 32(a) of the 1940 Act – annual meeting
- Ratification is required if
  - Board members are required to be elected
- Under Rule 32a-4, ratification is not required if:
  - Board has an audit committee comprised solely of independent directors
  - Audit committee adopts a written charter
  - Fund maintains a permanent copy of the charter

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# Please answer the following Polling Question

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## Amendments to Governing Documents

- State law and/or governing documents may require shareholder approval of amendment
- Under Item 19 of Schedule 14A, discuss reasons and effect



## Procedures for Definitive Materials

- These materials must be filed no later than the mailing date (Rule 14a-6(b))
- In addition, for funds whose shares are listed on the NYSE, copies of the materials must be filed with the Exchange no later than the mailing date (Section 402.01)
- There is generally no filing fee
- Notice of the meeting is generally required under the fund's charter documents and relevant state law
- There may be additional definitive materials summarizing the matters to be voted upon and encouraging shareholders to vote:
  - Usually filed with the SEC
  - May not be subject to comment if no new information is included
  - May still be looked at by SEC examiner even if not normally reviewed

## Proxy Card (Rule 14a-4)

- Identify each item to be voted on
  - Provide choice to approve, disapprove or abstain
  - For the election of directors, provide the name of each nominee and a means and instruction on how to designate that the authority to vote for a nominee is withheld
  - For the election of directors, if applicable state law gives legal effect to votes against a nominee, then in lieu of or in addition to the means to withhold, provide a means and instruction on how to vote against a nominee

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## Proxy Card

- Telephonic or electronic voting
  - Permissible under state law
  - Verification of authenticity using a PIN number
  - Shareholder opportunity to verify the vote
  - Record retention

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## Proxy Solicitors/Services

- Often used when a vote may be difficult to get due to
  - number of shareholders
  - size of shareholder holdings
  - nature of proposals
- Specific proxy statement disclosure is required
  - estimated costs
  - material terms of the agreement
- Third party proxy services

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## Shareholder Proposals (Rule 14a-8)

- Shareholders may submit their own proposals to be included in the fund's proxy statement if the following requirements are met:
  - One proposal is made with a 500 word supporting statement
  - The shareholder continuously held at least $2,000 in market value or 1% of shares entitled to vote on the proposal for one year prior to the date the proposal is submitted and continues to hold the shares at the meeting
  - The proposal makes the submission deadline of 120 days before the date the company's proxy statement was released to shareholders in connection with the previous year's annual shareholder meeting
  - The shareholder attends the meeting or sends a legal representative

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## Shareholder Proposals

- The fund may seek to exclude the proposal by submitting reasons to the SEC at least 80 days prior to filing the definitive proxy statement
- The fund may also include an opposition statement in the proxy statement
- If attempting to exclude, the fund must give shareholders the chance to cure any deficiencies within 14 days of notice

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## Mergers/Reorganizations

- Merger proxy statements must be prepared in accordance with Form N-14 that is equivalent to
  - A proxy statement for the acquired fund
  - A registration statement (prospectus and statement of additional information) for the acquiring fund
  - A description of the transaction and the two funds
- Special Form N-14 Issues
  - Filing period is different
    - 30 day filing period (*cf.* routine proxy statement that requires a 10 day filing period) if filing under Rule 488
  - Mail a minimum of 20 business days prior to meeting; otherwise include the SAI and other incorporated documents in the mailing

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## Mergers/Reorganizations

- Special Form N-14 Issues
  - Rule 17a-8 governs mergers of affiliated funds
    - A 1940 Act majority of the shareholders eligible to vote if an acquired fund's shareholders must vote in favor of the merger (Rule 17a-8(a)), unless:
      - the surviving fund's fundamental investment policies are not materially different from the acquired fund's;
      - the investment advisory agreement(s) of the acquired fund are not materially different from an investment advisory agreement of the surviving fund (other than the identity of the contracting fund);
      - the independent directors of the acquired fund who were elected by its shareholders will comprise a majority of the independent directors in the surviving fund; and
      - the surviving fund's authorized 12b-1 fees are no higher than the acquired fund's.

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## Householding Proxy Materials

- Under Rule 14a-3 of the Proxy Rules and Item 23 of Schedule 14A, in order to household proxy materials, the fund must receive affirmative written consent from shareholders, but may use a negative consent if shareholders are family members
- Materials must be properly addressed
- Shareholders must receive individual proxy cards
- There must be an opportunity for a shareholder to revoke consent and to receive separate proxy materials
- Materials may be delivered electronically

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# Please answer the following Polling Question



## E-Proxy Rules

- 2007 Amendments to the proxy rules require funds and other soliciting persons to provide shareholders with Internet access to proxy materials for most proxy solicitations
- Funds must choose one of two models: the "notice only option" and the "full set delivery option"
- Notice only option: funds may satisfy their delivery obligations by posting proxy materials on a publicly accessible Web site and sending a Notice of Internet Availability of Proxy Materials to shareholders at least 40 days before the shareholder meeting
  - All proxy materials, other than additional soliciting materials, must be posted by or before mailing of the Notice
  - The Notice must contain the information outlined in 14a-16(d)
  - Shareholders must be given the opportunity to elect to receive paper materials
- Full set delivery option: funds must deliver the Notice to shareholders in paper format along with a complete set of proxy materials. In addition, the proxy materials must be posted on a Web site no later than the date the Notice was first sent to shareholders.

## SEC's Concept Release on the U.S. Proxy System

- Issued July 14, 2010
- www.sec.gov/rules/concept/2010/34-62495.pdf
- Sought comment on the U.S. proxy system in general and certain related matters. Comments were due October 20, 2010
- Areas of general concern addressed, including
  - Over-voting and under-voting by securities intermediaries
  - Ability to confirm investor voting instructions
  - Proxy voting by institutional securities lenders
  - Proxy material distribution fees
  - Ability of issuers to communicate with shareholders/beneficial owners
  - Facilitating/encouraging retail investor participation
  - Oversight of proxy advisory firms

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# Questions?

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