

ALERTS

Regulated Funds: SEC Final Rule Declines to Apply Universal Proxy Card Mandate to Regulated Funds

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On Nov. 17, 2021, the Securities and Exchange Commission (“SEC”) adopted final rules requiring participants in contested director elections to use universal proxy cards that include all director nominees presented for election at a shareholder meeting (“Rules”).^[1] The Rules allow for shareholders voting by proxy to vote for a combination of director nominees from competing slates, just as they could at an in-person meeting. Notably, consistent with the 2016 Proposing Release,^[2] the Rules as adopted do not apply to solicitations for contested elections involving registered investment companies registered under Section 8 of the Investment Company Act of 1940 (“1940 Act”) or business development companies as defined by Section 2(a)(48) of the 1940 Act (“BDCs,” together with registered investment companies, “Regulated Funds”).^[3]

The SEC noted in the Adopting Release that it continues to consider whether the Rules should apply to some or all Regulated Funds.^[4] In reaching its decision to exclude Regulated Funds from the Rules, the SEC considered various comments, many of which focused on the differences between Regulated Funds and operating companies, the unique governance structures of funds, and the different structures of open and closed-ended funds.^[5] The below outlines significant areas of attention for commenters observed in the Adopting Release^[6]:

- A significant number of commenters supported excluding Regulated Funds from the mandate in view of purported differences between

Regulated Funds and operating companies, mainly relating to the protections those commenters believed investors in such Regulated Funds enjoyed under federal securities laws, including the 1940 Act, and various state corporate law provisions that provide shareholders the right to approve certain fundamental fund features in certain cases.

- In contrast, other commenters supported the application of the mandate to Regulated Funds, in the manner suggested in the Reopening Release, on the basis that excluding Regulated Funds would continue to make it difficult for investors to enact change when necessary. Such commenters focused particularly on the large number of retail investors in these funds.
- Several commenters also argued that split-ticket voting would disrupt the unitary and cluster board structures that are commonly utilized by funds, resulting in additional administrative complexities, the cost of which would ultimately fall to fund shareholders. In contrast, one commenter in favor of applying the mandate to Regulated Funds called into question whether the use of unitary and cluster board structures actually benefits Regulated Funds and their shareholders, while another argued that allowing shareholders to promote the nominees of their choosing should be considered before any purported administrative efficiency.
- Finally, other commenters pointed out that, given the organizational complexities of and the rarity of contested elections involving open-ended registered funds, universal proxies were not necessary for those types of Regulated Funds.

The SEC's decision to not apply the Rules to Regulated Funds, despite suggesting it may do so in the Reopening Release, continues an apparent trend at the SEC away from regulatory positions that may tend to encourage activism within the Regulated Fund space, particularly with respect to registered closed-end funds and BDCs. Notably, the SEC's withdrawal of the *Boulder* no-action letter in 2020,^[7] which opened the door towards the adoption of a wider scope of anti-takeover provisions at Regulated Funds, continues to impact the scope and nature of shareholder activism within the Regulated Fund space generally. While the language included in the Reopening Release suggested that the pendulum may be swinging back towards a more neutral position, the SEC's determination to omit Regulated Funds from the universal proxy mandate set forth in the Rules likely means that the Regulated Fund

space will continue to remain challenging for less sophisticated shareholder activists in the short term. Those trends do not foreclose opportunities for activism in the Regulated Funds space, however, but rather emphasize the need for sophisticated counsel to navigate both potential regulatory hurdles and opportunities.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] See “Universal Proxy,” Exchange Act Release No. 34-93596 (Nov. 17, 2021), available here (“Adopting Release”).

[2] In 2016, the SEC proposed rule amendments to mandate the use of universal proxy cards in contested director elections (“Proposing Release”). See “Universal Proxy,” Exchange Act Release No. 34-79164 (Nov. 10, 2016), available here. In 2021, in light of developments since the publication of the Proposing Release, the SEC reopened the comment period for the Proposing Release allowing commentators to provide additional comments and analysis, including on, among other topics, the desirability of extending the universal proxy mandate applicable to Regulated Funds (the “Reopening Release”). See “Reopening of Comment Period for Universal Proxy,” Exchange Act Release No. 34-91603 (May 6, 2021), available here.

[3] See Exchange Act Release No. 34-93596 at 10-11 and 67.

[4] See *id.* at 67.

[5] See *id.* at 65-67.

[6] See *id.*

[7] In 2010, the SEC released a no-action letter to Boulder Total Return Fund (“Boulder Letter”), stating that by opting into a state statute that limits the voting rights of control shares, a closed-end fund would be operating in a manner inconsistent with Section 18(i) of the 1940 Act. See Boulder Letter, SEC No-Action Letter (Nov. 15, 2010) (withdrawn May 27, 2020), available here. In 2020, the SEC withdrew the Boulder Letter, taking the position, that under certain circumstances, a closed-end fund may opt into a state control share statute without risking an enforcement action against the fund under Section 18(i).

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