FUND SOLUTIONS

VIEWS ON THE NEWS

SEC WEIGHS ELIMINATION OF ANNUAL MEETING REQUIREMENT FOR CLOSED-END FUNDS

December 2024

THE FACTS

The New York Stock Exchange (NYSE) recently proposed eliminating the requirement for closed-end funds (CEFs) to hold annual shareholder meetings, a rule in place since the 1920s. This proposal follows advocacy from the Investment Company Institute (ICI), which submitted a comment letter to the SEC supporting the change. Historically, this requirement provided a forum for shareholders to hold fund managers accountable, but the ICI argues that the annual meetings now primarily benefit activist investors, not retail shareholders. They point out that the **Investment Company Act of 1940** already includes extensive protections for CEF investors, including independent board oversight and requirements for shareholder approval of significant changes.

Critics, including some academics and former SEC officials, caution that eliminating the annual meeting requirement could erode shareholder rights, especially for existing funds. At the 2024 ICI Closed-End Fund Conference, Dalia Blass, former Director of the SEC's Division of Investment Management, described the annual meeting requirement as a "historical aberration." However, she emphasized that removing it from existing funds could disenfranchise shareholders who invested with the expectation of annual meetings. Blass suggested that while new CEFs could have the flexibility to opt-in to the annual meeting requirement - allowing them to modernize operations while offering shareholders governance rights - existing funds should retain it to preserve current shareholders' original value proposition and governance rights. She noted that her perspective was influenced by Jay Clayton, former SEC Chairman, who shares similar views.

OUR TAKE

The annual meeting requirement is a legacy rule that may no longer serve the interests of CEF shareholders in its current form. While annual meetings were once crucial for shareholder oversight, the protections of the Investment Company Act of 1940 have largely primarily replaced the need for such frequent governance forums. CEFs' fixed-share structure does make them more vulnerable to activist influence, as shareholders can't simply redeem at NAV as they would with mutual funds. This feature has led to a rise in activist campaigns that exploit annual meetings to push agendas that may favor short-term gains over long-term stability.

Eliminating annual meetings for new funds could reduce operational costs and prevent activist campaigns that disrupt a fund's purpose, ultimately protecting retail investors focused on income stability. However, it's essential that any change must preserve the protections of the 1940 Act, ensuring investors retain control over significant governance shifts and continue to benefit from board oversight by independent directors. The perspective offered by Dalia Blass adds balance to the debate: by retaining the annual meeting requirement for existing funds, the expectations and governance rights of current shareholders are respected, while allowing new funds the option to opt-in to the requirement provides flexibility to modernize fund structures while considering investor preferences from the outset. Transparency must remain a priority, and CEF boards should enhance shareholder communication to ensure accountability, even without annual meetings.

Views on the News, by the Fund Solutions team, provides critical insights into the evolving landscape of registered fund governance and activism, equipping fund managers with the tools they need to navigate these challenging and ever-shifting tides.

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