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A legal update from Dechert's Financial Services Group

NYSE Proposes Exemption for Proxy Voting for Uncontested Election of Investment Company Directors

Introduction

On May 23, 2007, the New York Stock Exchange (the "Exchange") proposed an amendment to its initial rule proposal to amend Exchange Rule 452. Under the proposed amendment, any company registered under the Investment Company Act of 1940 (the "1940 Act") would not be subject to the change to discretionary voting for uncontested election of directors.[1]

The initial rule proposal, filed with the U.S. Securities and Exchange Commission (the "SEC") on October 14, 2006, called for the amendment of Exchange Rule 452 (Giving Proxies by Member Organization) to eliminate broker discretionary voting for the uncontested election of directors.[2] The proposal followed recommendations of the Proxy Working Group, created in April 2005 by the Exchange, to review the proxy voting process.

Discussion

Under current Exchange and SEC proxy rules, brokers must deliver proxy materials to beneficial owners and request voting instructions in return. If voting instructions have not been received by the tenth day preceding the meeting date, Exchange Rule 452 provides that brokers may vote on certain matters deemed "routine" by the Exchange. Among the matters still considered "routine," and thus eligible for broker-voting, is the uncontested election of directors.

If approved by the SEC, the initial rule proposal would apply to proxies relating to closed-end funds and mutual funds whose shares were held through Exchange member firms.

The Exchange proposes to amend Rule 452 to eliminate broker discretionary voting for the uncontested election of directors, but to except from the amendment companies registered under the 1940 Act. The proposal follows a decision by the Proxy Working Group to amend its initial recommendation to the Exchange and to recommend that such changes to Exchange Rule 452 not apply to investment companies.

The Proxy Working Group made its recommendation after reviewing materials submitted by the Investment Company Institute ("ICI") and other representatives of investment companies concerning the difficulties such companies would have faced if they were subject to the amendment to Exchange Rule 452 making director elections "non-routine." The Proxy Working Group relied on information submitted by the ICI, which included analyses about the additional costs that would be incurred by investment companies if such companies would not be allowed to count broker-votes in uncontested election for directors,[3] as well as the different shareholder profiles of investment companies and operating companies, and the differing regulatory regimes of investment companies.

1 SR-NYSE-2006-92, Amendment No. 1.

2 SR-NYSE-2006-92.

3 Investment Company Institute, *Costs of Eliminating Discretionary Broker Voting on Uncontested Elections of Investment Company Directors* (December 18, 2006).

Specifically, the Proxy Working Group considered the heightened problems investment companies face because of their disproportionately large retail shareholder base and the fact that investment companies are subject to regulation under the 1940 Act. The Proxy Working Group concluded that the unique regulatory regime governing investment companies made them sufficiently different from operating companies that it was appropriate to treat investment companies differently.

At the time of drafting this update, NYSE has not filed, nor has the SEC acted on the amended rule proposal. Assuming that the SEC will approve the initial rule proposal, it is scheduled to be applicable to proxy voting for shareholder meetings held on or after January 1, 2008. The status of the amended rule proposal remains uncertain.

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This update was authored by Stephen H. Bier (+1 212 698 3889; stephen.bier@dechert.com), Alan Rosenblat (+1 202 261 3332; alan.rosenblat@dechert.com), and Joseph P. Kelly II (+1 949 442 6027; joseph.kelly@dechert.com).

Practice group contacts

For more information, please contact the authors, one of the attorneys listed, or any Dechert attorney with whom you regularly work. Visit us at www.dechert.com/financialservices.

Margaret A. Bancroft
New York
+1 212 698 3590
margaret.bancroft@dechert.com

Allison R. Beakley
Boston
+1 617 728 7124
allison.beakley@dechert.com

Sander M. Bieber
Washington, D.C.
+1 202 261 3308
sander.bieber@dechert.com

Stephen H. Bier
New York
+1 212 698 3889
stephen.bier@dechert.com

Daphne T. Chisolm
Charlotte
+1 704 339 3153
daphne.chisolm@dechert.com

Christopher D. Christian
Boston
+1 617 728 7173
christopher.christian@dechert.com

Timothy M. Clark
New York
+1 212 698 3652
timothy.clark@dechert.com

Elliott R. Curzon
Washington, D.C.
+1 202 261 3341
elliott.curzon@dechert.com

Douglas P. Dick
Newport Beach
+1 949 442 6060
douglas.dick@dechert.com

Steven S. Drachman
New York
+1 212 698 5627
steven.drachman@dechert.com

Ruth S. Epstein
Washington, D.C.
+1 202 261 3322
ruth.epstein@dechert.com

Susan C. Ervin
Washington, D.C.
+1 202 261 3325
susan.ervin@dechert.com

Joseph R. Fleming
Boston
+1 617 728 7161
joseph.fleming@dechert.com

Brendan C. Fox
Washington, D.C.
+1 202 261 3381
brendan.fox@dechert.com

Wendy Robbins Fox
Washington, D.C.
+1 202 261 3390
wendy.fox@dechert.com

David M. Geffen
Boston
+1 617 728 7112
david.geffen@dechert.com

David J. Harris
Washington, D.C.
+1 202 261 3385
david.harris@dechert.com

Robert W. Helm
Washington, D.C.
+1 202 261 3356
robert.helm@dechert.com

Jane A. Kanter
Washington, D.C.
+1 202 261 3302
jane.kanter@dechert.com

Stuart J. Kaswell
Washington, D.C.
+1 202 261 3314
stuart.kaswell@dechert.com

George J. Mazin
New York
+1 212 698 3570
george.mazin@dechert.com

Jack W. Murphy
Washington, D.C.
+1 202 261 3303
jack.murphy@dechert.com

John V. O'Hanlon
Boston
+1 617 728 7111
john.ohanlon@dechert.com

Fran Pollack-Matz
Washington, D.C.
+1 202 261 3442
fran.pollack-matz@dechert.com

Jeffrey S. Puretz
Washington, D.C.
+1 202 261 3358
jeffrey.puretz@dechert.com

Jon S. Rand
New York
+1 212 698 3634
jon.rand@dechert.com

Robert A. Robertson
Newport Beach
+1 949 442 6037
robert.robertson@dechert.com

Keith T. Robinson
Washington, D.C.
+1 202 261 3386
keith.robinson@dechert.com

Alan Rosenblat
Washington, D.C.
+1 202 261 3332
alan.rosenblat@dechert.com

Frederick H. Sherley
Charlotte
+1 704 339 3100
frederick.sherley@dechert.com

Patrick W. D. Turley
Washington, D.C.
+1 202 261 3364
patrick.turley@dechert.com

Brian S. Vargo
Philadelphia
+1 215 994 2880
brian.vargo@dechert.com

David A. Vaughan
Washington, D.C.
+1 202 261 3355
david.vaughan@dechert.com

Anthony H. Zacharski
Hartford
+1 860 524 3937
anthony.zacharski@dechert.com

Dechert LLP

www.dechert.com

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