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Skadden

Investment Management Alert

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SEC Relaxes 'In-Person' Voting Requirements for Investment Company Boards

On February 28, 2019, the Division of Investment Management (staff) of the Securities and Exchange Commission (SEC) issued a no-action letter (IDC letter)[1] relaxing its views on "in person" voting requirements for investment company[2] boards of directors. In the IDC letter the staff states that it would not recommend action to the SEC for violations of Sections 12(b), 15(c) or 32(a) of the Investment Company Act of 1940 (1940 Act), or Rules 12b-1 or 15a-4(b)(2) thereunder, if investment company directors, in certain circumstances, approve the company's investment management agreement or certain other matters (required approvals) telephonically, by video conference or by other means by which all participating directors may participate and communicate with each other simultaneously during a meeting, instead of at a meeting where the required directors are physically present.[3]

The circumstances to which this position apply are:

1. **Emergency Situations:** the directors needed for the required approval physically cannot be present due to unforeseen or emergency circumstances, provided that (i) no material changes to the relevant contract, plan and/or arrangement are proposed to be approved, or are approved, at the meeting, and (ii) such directors ratify the applicable approval at the next board meeting at which the directors needed for the required approval are physically present; and
2. **Prior Discussion Situations:** the directors needed for the required approval previously fully discussed and considered all material aspects of the proposed matter at a meeting where the required directors were physically present, but did not vote on the matter at that time, provided that no director requests another meeting where all required directors are physically present.

[1] Independent Directors Council, SEC Staff No-Action Letter (Feb. 28, 2019).

[2] An "investment company" for purposes of the IDC letter includes a registered management investment company (or a separate series thereof, as the context requires) or a business development company.

[3] While the 1940 Act itself does not define what "in person" means, the "in person" meeting requirement historically has been interpreted to mean that directors physically must be present when voting. *See* Provisions of Investment Company Amendments Act of 1970 Concerning Approval of Advisory Contracts and Other Matters for Consideration by Registrants at 1971 Annual Meetings, SEC Release No. IC-6336, at n. 3 (Feb. 2, 1971) ("[The in-person voting requirement of Section 15(c)] is also a new requirement imposed by the [1970 Amendments] which cannot be complied with by voting over the telephone, through the use of a closed-circuit television conference, by proxy or otherwise than by personal appearance.").

The required approvals to which this position apply are:

1. renewal (or approval or renewal in the case of prior discussion situations) of an investment advisory contract or principal underwriting contract pursuant to Section 15(c) of the 1940 Act;
2. approval of an interim advisory contract pursuant to Rule 15a-4(b)(2) under the 1940 Act (with respect to prior discussion situations only);[4]
3. selection of the fund's independent public accountant pursuant to Section 32(a) of the 1940 Act (with respect to emergency situations, such accountant must be the same accountant as selected in the immediately preceding fiscal year); and
4. renewal (or approval or renewal in the case of prior discussion situations) of the fund's 12b-1 Plan.[5]

Emergency Situations

The Independent Directors Council's request for relief (IDC relief request) describes a variety of scenarios that could fall within the relief granted for emergency situations. As described in the IDC relief request, unforeseen or emergency circumstances include any circumstances that, as determined by the board, could not have been reasonably foreseen or prevented and that make it impossible or impracticable for directors to be physically present at a meeting. According to the IDC relief request, such circumstances would include, but not be limited to, illness or death, including of family members; weather events or natural disasters; acts of terrorism; and disruptions in travel that prevent some or all directors from physically being present at the meeting. Importantly, boards will be able to determine whether unforeseen or emergency circumstances exist, and such determinations should be reflected in board minutes and subject to ordinary fiduciary and business judgment principles.

The emergency situations relief does not apply in situations such as a change in control of an investment adviser to a fund that results in the termination of the prior contract, or the approvals required to launch a new fund (*i.e.*, investment advisory contract, principal underwriting contract and auditors). As in the past, funds and their boards could seek individualized relief in these circumstances.

Prior Discussion Situations

As described in the IDC relief request, relief for the prior discussion situations especially will be helpful in the following scenarios:

1. if directors prefer to wait to vote until after a contingent event takes place, such as the vote of shareholders of the investment adviser or a parent company of the investment adviser with respect to a proposed change of control of the adviser or parent company;
2. if a majority of independent directors have selected the independent public accountant for certain funds in a fund complex and subsequently select the same independent public accountant at a later date for other funds in the same fund complex that have different fiscal years and a majority of the independent directors have concluded that no additional information is needed from the independent public accountant; or
3. if directors wish to wait to vote on a matter until further requested information is provided or previously provided information is confirmed, and they determine at the meeting where the required directors are physically present that the nature of the information to be provided or confirmed would not likely change the vote of any director needed for the required approval.

In the event that information provided or discovered after the meeting where the required directors are physically present in fact results in a change in the vote of any director needed for a required approval, or any director requests another meeting where the required directors are physically present in order to vote, the required directors would need to physically attend an additional meeting to reconsider the matter.

[4] Rule 15a-4(b)(2) applies to situations where the prior advisory contract was terminated by assignment (which is defined in the 1940 Act to include a change in control of the investment adviser) and the adviser receives money or other benefit in connection with the assignment. In contrast, Rule 15a-4(b)(1) applies to situations where the board or shareholders terminate the prior contract, the board fails to renew the prior contract or the prior contract is terminated by assignment and the adviser does not receive money or other benefit in connection with the assignment. By rule, approval of an interim advisory contract in the situations described in Rule 15a-4(b)(1) may be accomplished "at a meeting in which directors may participate by any means of communication that allows all directors participating to hear each other simultaneously during the meeting."

[5] Rule 12b-1(b)(2) and 12b-1(b)(3)(i), which provide for initial and annual "in person" voting requirements, apply not only to the 12b-1 Plan itself, but also to any agreements related to the 12b-1 Plan. While the Independent Directors Council's request for relief appears to contemplate the inclusion of implementing agreements ("The requested no-action position would only apply to Board Actions where a fund's board is renewing an existing contract, plan, or *arrangement* ...") (*emphasis* added), the formal request covers only the 12b-1 Plan itself. Because there is no reason to distinguish between a 12b-1 Plan and its implementing agreements for this purpose, confirmation from the staff that agreements related to the 12b-1 Plan are covered by the position expressed in the IDC letter would be helpful.

Conclusions

The IDC letter is a welcome development for the registered fund and business development company industry, and we believe it will significantly ease unnecessary costs and burdens on boards and independent directors. In granting the requested relief, the staff noted that the relief "would remove significant or unnecessary burdens for funds and their boards … [and] would [not] diminish the board's ability to carry out its oversight role or other specific duties."

The IDC letter also marks yet another welcome step in the staff's evolving views with respect to board oversight[6] and is a further expression of the staff's commitment to review existing director responsibilities in light of market, regulatory and technological developments, and to consider whether they are appropriate and are carried out in a manner that serves shareholders' best interests.[7]

Boards should, however, be cognizant that the IDC letter represents only the views of the staff with respect to the recommendation of enforcement action; it is not a law and it is not a rule, regulation or statement of the SEC, which has neither approved nor disapproved its content. Accordingly, while it is at least theoretically possible the SEC could disagree with its staff and challenge such an approval, we think that is highly unlikely. In addition, based on court cases to date, there is no private right of action under the relevant provisions. In any event, there would be no necessity for a court to view the statutory "in person" requirement as necessitating physical presence and reliance on a staff position likely would be given significant weight in any determination.

Boston associate Benjamin Niehaus contributed to this client alert.

[6] *See, e.g.* Independent Directors Council, SEC Staff No-Action Letter (Oct. 12, 2018). The staff agreed not to recommend enforcement action to the SEC for violations of Sections 10(f), 17(a) or 17(e) of the 1940 Act if a fund's board of directors receives, no less frequently than quarterly, a written representation from the chief compliance officer that transactions effected in reliance on Rules 10f-3, 17a-7 or 17e-1 under the 1940 Act (exemptive rules) complied with the procedures adopted by the board pursuant to the relevant exemptive rule, instead of the board itself determining compliance.

[7] *See* Dalia Blass, Director, Division of Investment Management, SEC, Keynote Address: ICI Securities Law Developments Conference (Dec. 7, 2017).