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SEC Loosens In-Person Voting Requirements for Mutual Fund and other Registered Investment Company Boards

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As just about everyone who operates in the mutual fund, closed-end fund or exchange-traded fund (ETF) industries knows, the Investment Company Act of 1940, as amended (the "1940 Act"), requires certain key registered investment company agreements be approved at an "in-person" meeting of the fund's board (the "Required Approvals"). [1] This "in-person" requirement – which generally requires at least a majority of the board members (and a majority of the independent board members) to be physically present in the same room – is normally satisfied by approving the key agreements at regularly scheduled annual meetings.[2] While this approach normally ensures timely approval, unexpected or emergency circumstances present challenges, particularly when a majority of the board members are in different cities. In an important first, the SEC recently provided limited relief from the in-person requirement through a no-action letter (the "Letter"). [3] Though limited in scope, the Letter may be a long-promised first step in modernizing board voting rules under the 1940 Act in light of the benefits of modern communications technology. [4]

In the Letter, the SEC agreed that relief from compliance was appropriate "where in-person voting requirements may create a significant or unnecessary burden for funds and their boards that outweigh any benefits to fund shareholders."[5] Accordingly, the Letter provides relief for board members to vote on the Required Approvals via telephone, video conference, or similar means that allow board members to participate and communicate with each other simultaneously during the meeting, rather than through an in-person meeting, so long as either:

1. unforeseen or emergency circumstances prevent the directors from meeting in person, provided that (i) the changes being voted on are not material, and (ii) the directors ratify the approval at the next in-person meeting ("Exception 1"); or
2. the directors needed for the Required Approval fully discussed and considered all material aspects of the proposal, but did not vote on the proposal, at a prior in-person meeting, so long as no director requests another in-person meeting ("Exception 2"). [6]

However, the Letter only applies to approvals of the following transactions:

1. the renewal, or in the case of Exception 2, the approval or renewal, of an investment advisory contract or

principal underwriting contract under Section 15(c) of the 1940 Act;

2. with respect to Exception 2, the approval of an interim advisory contract under Rule 15a-4(b)(2) under the 1940 Act;
3. the selection of the fund's independent public accountant under Section 32(a) of the 1940 Act; provided, however, that in the case of Exception 1, the accountant must be the same accountant selected in the immediately preceding fiscal year; and
4. the renewal, or in the case of Exception 2, the approval or renewal, of the fund's 12b-1 plan. [7]

Several of our mutual fund, closed-end fund and ETF clients have faced difficulties in the past where unforeseen events like canceled flights and bad weather prevented board members from voting on routine, but important, fund proposals. In some instances, the funds (and, indirectly, the shareholders) incurred additional costs associated with holding another in-person board meeting, while the fund's shareholders received no material benefit from such meeting. We believe the Letter is an important first step by the SEC to balance the value of face-to-face board approvals with the benefits of modern technology for the betterment of fund governance overall.

If you have any questions about the Letter or about the regulation of mutual funds generally, please feel free to contact us.

*By the **Investment Management and Broker-Dealer Team** at **Kilpatrick Townsend & Stockton***

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[1] Section 15(c) of the 1940 Act requires that the terms of an investment advisory contract or principal underwriting agreement and any renewal thereof be approved by the vote of a majority of the fund's directors who are not parties to the contract or agreement or "interested persons" (as defined in Section 2(a)(19) of the 1940 Act) of any such party. Rule 12b-1 under the 1940 Act requires that a plan regarding distribution related payments pursuant to that Rule ("12b-1 Plan") be approved by a vote of the fund's board of directors, and of the directors who are not interested persons of the fund ("independent directors") and have no direct or indirect financial interest in the operation of the 12b-1 Plan or in any agreements related to the 12b-1 Plan. Rule 15a-4(b)(2) under the 1940 Act requires that certain interim contracts be approved by the vote of the fund's board of directors, including a majority of independent directors. Section 32(a) requires that independent public accountants be selected by a vote of a majority of the fund's independent directors.

[2] *See id.*

[3] SEC No Action Letter, Independent Directors Council (Feb. 28, 2019), https://www.sec.gov/divisions

/investment/noaction/2019/independent-directors-council-022819.

[4] *See* Dalia Blass, Director, Division of Investment Management, SEC, Keynote Address: ICI Securities Law Developments Conference (Dec. 7, 2017). *See also* Independent Directors Council, SEC No-Action Letter (Oct. 12, 2018).

[5] SEC No Action Letter, *supra* note 3.

[6] Independent Directors Council, Request for SEC No-Action Position (Feb. 28, 2019), https://www.sec.gov/divisions/investment/noaction/2019/independent-directors-council-022819-incoming.pdf.

[7] *Id.* at 2-3.