

Update 2005-25  
October 2005

# Legal Update: *NYSE Revises Position on Voting "Uninstructed Shares" in connection with Changes in Funds' Advisers*

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On October 6, 2005, the SEC issued a Notice announcing the immediate effectiveness of, and seeking comment on, a proposal by the New York Stock Exchange, Inc. to prohibit NYSE member firms from voting shares for which the beneficial owners have not given voting instructions (uninstructed shares) where the matter in question is a change in an investment company's investment adviser. Release No. 34-52569; available at <http://a257.g.akamaitech.net/7/257/2422/01jan20051800/edocket.access.gpo.gov/2005/pdf/E5-5646.pdf>. The NYSE consulted with staff from the SEC Division of Investment Management (IM) on the matter, but did not seek (or receive) comments on the proposal (which reverses its longstanding position that allowed members to vote uninstructed shares in certain such cases). Even though the new position has already become effective, the SEC is accepting comments on it, and asks that comments be submitted before November 4, 2005.

### Background

It is a common practice for broker-dealers (such as NYSE member firms) to allow their customers (the "beneficial owners") to have their stock holdings registered in the member's name. Because the entitlement to vote shares of stock is phrased in terms of registered owners, broker-dealers normally have to seek proxy voting instructions from the beneficial owners. However, NYSE Rule 452 (which is referenced in Sections 402.06 and 402.08 of the NYSE's Listed Company Manual) provides that a member may give a proxy to vote shares registered in its name, notwithstanding the failure of the beneficial owner to instruct the firm how to vote, provided (among other

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things) that the proposal being voted on does not involve a matter that "may affect substantially the rights or privileges of such stock."

By way of example, Supplementary Material .11 to Rule 452 lists 18 actions with regard to which members may not vote uninstructed shares. In addition, the NYSE has interpreted Rule 452 to preclude members from voting without instructions in certain other situations, including any "material amendment" to the investment advisory contract with an investment company. See, Release No. 34-30697 (May 13, 1992). However, according to the Notice, "for many years," the NYSE interpreted this provision to permit members to vote uninstructed shares on the authorization of new investment advisory contracts, where the change in identity of the adviser was the only change being made to the substantive terms of the contract (e.g., no change in advisory fees was being proposed).

### **The New Position**

According to the Notice, following discussions with IM, the NYSE has now "determined that any proposal to obtain shareholder approval of an investment company's investment advisory contract with a new investment adviser, which approval is required by the Investment Company Act of 1940, as amended (1940 Act), and the rules thereunder, will be deemed to be a 'matter which may affect substantially the rights or privileges of such stock' for purposes of Rule 452." Thus, in such matters, a member may not now give a proxy to vote shares registered in its name absent instruction from the beneficial owner. As a result, a member may not give a proxy to vote shares registered in its name, absent instruction from the beneficial owner, on any proposal to obtain shareholder approval required by the 1940 Act of an investment advisory contract between an investment company and a new investment adviser because, for example, of an "assignment" of the investment company's advisory contract, including an assignment caused by a change in control of the adviser.

Funds have often experienced difficulty in securing enough votes from shareholders even to achieve quorum, and this change in NYSE's position will only exacerbate the problem. In addition, funds have been known to take matters to shareholders even when the 1940 Act would not appear to require them to do so. In such cases, funds (or their counsel) might now be called upon to demonstrate to the NYSE that, even though they are seeking shareholder approval of a "new" investment adviser, such action would not be required by the 1940 Act.

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