PROFESSORS LUCIAN A. BEBCHUK & ROBERT J. JACKSON, JR.

July 30, 2024

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, Northeast
Washington, D.C. 20549

Re: Proposals to Exempt Closed-End Funds Registered Under the Investment Company Act from the Requirement to Hold Annual Shareholder Meetings

Dear Ms. Countryman:

We write regarding proposed exchange rule changes now before the SEC that would eliminate longstanding rules requiring closed-end funds to hold annual shareholder meetings.[1] As explained below, these Proposals raise serious governance and economic concerns. The exchanges advancing them have not provided adequate analysis of these issues.[2] Thus, upon the "independent review" the SEC is "obligated" to conduct, the Proposals should be disapproved.[3]

We are academics who research and teach corporate and securities law. Lucian Bebchuk is James Barr Ames Professor of Law, Economics, and Finance, and Director of the Program on Corporate Governance, at Harvard Law School. Robert Jackson is Nathalie P. Urry Professor of Law at the NYU School of Law and Co-Director of its Institute for Corporate Governance and Finance; in 2017 the President nominated him, and the Senate unanimously confirmed him, to serve as a Commissioner of the U.S. Securities and Exchange Commission. We write in our individual capacities; we note our institutional affiliations for identification purposes only.[4]

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[1] U.S. Sec. & Exch. Comm'n, New York Stock Exchange LLC, Notice of Filing of Proposed Rule Change Amending Section 302.00 of the NYSE Listed Company Manual to Exempt Closed-End Funds Registered Under the Investment Company Act of 1940 from the Requirement to Hold Annual Shareholder Meetings, Rel. No. 34-100460, 89 Fed. Reg. 56447 (July 3, 2024) [hereinafter the "NYSE Proposal"]; U.S. Sec. & Exch. Comm'n, Cboe BZX Exchange, Inc., Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 1, to Exempt Closed-End Fund Management Investment Companies Registered Under the Investment Company Act of 1940 from the Annual Meeting of Shareholders Requirement Set Forth in Exchange Rule 14.10(f), Rel. No. 34-100473, 89 Fed. Reg. 57491 (July 9, 2024) [hereinafter the "CBOE Proposal"; together with the NYSE Proposal, the "Proposals"].

[2] "Under the Commission's Rules of Practice, the 'burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change." U.S. Sec. & Exch. Comm'n, Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, Rel. No. 34-83723, 83 Fed. Reg. 37579-01, 37580 (2018) (citing U.S. SEC. & EXCH. COMM'N, COMMISSION RULE OF PRACTICE 700(B)(3), 17 C.F.R. § 201.700(b)(3)).

[3] *Susquehanna Int'l Group* v. *U.S. Sec. & Exch. Comm'n*, 866 F.3d 442, 447 (D.C. Cir. 2017) (Garland, J.) (the "Exchange Act and the [Administrative Procedure Act] require" "reasoned analysis" and "find[ings]" for rule approvals; the SEC may not simply "take [an exchange's] word for it" when approving proposed rule changes).

[4] We have been commissioned by Saba Capital Management, LP, to analyze the Proposals as independent experts. The compensation we are receiving for our work is in no way contingent on the conclusions of our analysis or the opinions that we here express. The views described in this comment reflect only our opinions, and do not represent the views of Saba Capital Management.

As NYSE's President once explained, NYSE's "long history of supporting good corporate governance" stretches back over a century.[5] And the SEC has long said that "corporate governance listing standards [are] of substantial importance to financial markets and the investing public," noting the "critical importance of annual meetings of shareholders to allow shareholders the ability to exercise their rights to participate in corporate governance matters."[6]

The Proposals depart from that history. They would undermine, not support, corporate governance by exempting closed-end funds (CEFs) from exchanges' annual shareholder meeting requirements—rules that have existed, and applied to CEFs, for decades. The SEC should disapprove the Proposals for five reasons, which we discuss in detail below:

- ***First***, the exchanges have ***not met their burden to provide analysis that could be the basis for approving the Proposals***. The exchanges do not claim that approval would serve investor protection, saying only that approval would not harm investors. Furthermore, the exchanges fail to support even that claim with analysis of the Proposals' effects. They merely assert that annual-meeting requirements are made unnecessary by existing legal protections—without explaining how.

- ***Second***, our analysis of the effects of eliminating the annual-meeting requirement shows that ***it would have substantial detrimental effects on CEF investors***. Such an elimination would entrench incumbent directors, weakening the election mechanism that is critical to CEF director accountability, and ***empirical evidence indicates that the expected costs of the produced entrenchment would be substantial.***

- ***Third***, the Proposals would frustrate the ***longstanding and legitimate expectations of millions of individual investors who now hold CEFs***. Given that the exchanges' annual-meeting requirements have been in place for decades, with little warning that the exchanges might eliminate them, investors who bought CEFs reasonably expected that they would continue to be protected by annual shareholder meetings.

- ***Fourth***, the Proposals ***do not identify any change in circumstances that could warrant eliminating the longstanding annual-meeting requirement.*** Rather than a response to changed circumstances, the Proposals can be viewed as another in a series of attempts to insulate CEF directors from accountability—yet the Proposals fail even to mention the Proposals' entrenchment effects or attempt to defend them.

- ***Fifth***, because the exchanges did not conduct an adequate examination of the Proposals' effects, and failed to consider or obtain relevant empirical evidence, ***the Proposals are the product of an ill-informed, flawed process***. Prompt Commission disapproval of proposals produced by such a process is warranted.

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[5] TOM FARLEY, PRESIDENT, NEW YORK STOCK EXCHANGE, *Foreword*, *in* NYSE CORPORATE GOVERNANCE GUIDE VI (2014) (noting that NYSE once "supported . . . the establishment of proxy solicitation regulations in 1927" in "recognition of the critical role the board plays in supporting good governance").

[6] U.S. Sec. & Exch. Comm'n, Rel. No. 34-82209, Self-Regulatory Organizations, The NASDAQ Stock Market LLC, Order Granting Approval of Proposed Rule Change, 81 Fed. Reg. 8582-02, 2016 WL 642600 (February 19, 2016).

The Proposals, which together span fewer than ten pages in the *Federal Register*, do not come close to carrying the substantial evidentiary burden that the exchanges and the Commission face when considering governance changes of this magnitude. For the reasons that follow, the case for prompt Commission disapproval of the Proposals is compelling.

I. THE EXCHANGES' FAILURE TO MAKE A CASE.

The Proposals would eliminate the longstanding requirements, in Section 302.00 of the NYSE Listed Company Manual and Rule 14.10(f) of the Cboe BZX Rule Book, that CEFs hold shareholder meetings each year.[7] The Commission's review of the Proposals, as with any changes to the rules of self-regulatory organizations (SROs) overseen by the SEC, is governed by the SEC's Rules of Practice, the Exchange Act, and the Administrative Procedure Act.[8]

The SEC's Rules of Practice require exchange proposals to give a "sufficiently detailed and specific" "description of a proposed rule change, its purpose and operation, [and] its effect" "to support an affirmative Commission finding" that, among other things, the proposal is "consistent with Exchange Act Section 6(b)(5),"[9] which, in turn, requires exchange rules "in general, to protect investors and the public interest."[10]

The "burden to demonstrate that a proposed rule change is consistent with the Exchange Act . . . is on the [SRO] that proposed the rule change."[11] "[A]ny failure of any SRO to provide th[e] information" necessary to carry that burden "may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act."[12] Thus, the "Commission shall disapprove a proposed rule change of [an SRO] if [the SEC] does not make a finding" "that such proposed rule change is consistent with the requirements of" the Exchange Act. And, the courts have explained, "[s]tating that a factor was considered—or found—is not a substitute for considering or finding it": an approval order must "reflect . . . evidence of the basis for the [SRO's and the SEC's] determinations."[13]

In light of these well-accepted requirements, one might expect the Proposals to include affirmative analysis supporting the conclusion that the Proposals would protect investors as well as the public interest. But neither of the Proposals even state that the rule changes would enhance investor protection. Instead, they say only that the SROs "believe[] that the proposed" "change is "consistent with" Section 6(b) of the [Exchange] Act," "because it is designed to" do the things

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[7] NEW YORK STOCK EXCHANGE LLC, NEW YORK STOCK EXCHANGE LISTED COMPANY MANUAL § 302.00 ("Companies listing common stock . . . are required to hold an annual shareholders' meeting for the holders of such securities during each fiscal year."); CBOE BZX EXCHANGE, INC., RULES OF CBOE BZX EXCHANGE § 14.10(f)(1).

[8] *See, e.g.*, *Susquehanna*, 866 F.3d at 447 ("The Exchange Act permits the SEC to approve [an SRO's] proposed rule change only if it finds that the proposal is consistent with the requirements of the [Exchange] Act," and the Administrative Procedure Act "require[s]" "reasoned analysis," proscribing approvals that are "unsupported by substantial evidence" (citing 5 U.S.C. § 706(2)(A),(E))).

[9] Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, *supra* note 2, 83 Fed. Reg. 37580.

[10] 15 U.S.C. § 78f(b)(5).

[11] COMMISSION RULES OF PRACTICE, *supra* note 2, 17 C.F.R. § 201.700(b)(3).

[12] Order Setting Aside Action by Delegated Authority and Disapproving a Proposed Rule Change, *supra* note 2, 83 Fed. Reg. 37580.

[13] *Susquehanna*, 866 F.3d at 446.

described in Section 6(b).[14] It is hard to think of a clearer case of an agency "stating, not finding," in then-Judge Garland's words, than the SEC approving an SRO proposal supported only by a "belief" about satisfaction of text pasted from Section 6(b) of the Exchange Act.

To be sure, the exchanges do provide a brief, summary statement seemingly seeking to explain their "belie[f]" that the Proposals would be "consistent with" investor protection and the public interest. The exchanges argue that, because (A) CEF investors enjoy protections conferred by the Investment Company Act of 1940 (the "ICA"), then (B) eliminating the annual-meeting requirement will not weaken the protection of CEF investors.

But (B) does not follow from (A). To see why, note that the exchanges do not contend that the ICA requires annual meetings and, thus, makes exchange rules doing so redundant; indeed, the Proposals expressly state that the proposal is "designed to permit CEFs to rely on the shareholder voting requirements under the [ICA] rather than complying with" "annual meeting requirements."[15] Rather, the exchanges' position appears to be that, because CEF investors are already sufficiently protected by the ICA, CEF investors have no need for, and investor protection would not be harmed by, eliminating the longstanding annual meeting requirement.

However, the Proposals do not provide any explanation as to why the ICA's statutory protections—fully accepting that they are beneficial for investors—make annual meetings unnecessary. It is clearly possible, and often the case, that having a given protection makes having another protection also beneficial, because investor protection might be served by having both the former and the latter protection. Indeed, as explained in Part III below, this is the case in the considered setting: retaining the annual meeting requirement alongside the ICA's protections, as the exchanges have long done, would benefit CEF investors and enhance their protection.

Before proceeding, we note that the exchanges rely on the presence of ICA protections to support eliminating the annual meeting requirement for CEFs while retaining this requirement for operating companies. For example, the NYSE Proposal claims:

> [T]here are significant differences between CEFs and listed operating companies that justify exempting CEFs from the Exchange's annual meeting requirement. In particular, the Exchange notes that the [ICA] includes specific requirements with respect to the election of directors by CEF shareholders, while there is no such requirement under federal law for listed operating companies[.][16]

Again, even assuming that CEF investors benefit from the ICA's protections relating to the election of directors, it does not follow that the annual meeting requirement does not benefit—and that eliminating that requirement would not hurt—CEF investors.[17] Thus, the

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[14] NYSE Proposal, *supra* note 1, 89 Fed. Reg. 56448.

[15] *Id*.

[16] *Id.* (citing 15 U.S.C. § 80a-16(a) (ICA provision governing election of investment-company directors).

[17] Moreover, we find unpersuasive the Proposals' claim that, putting aside the exchanges' annual-meeting requirement, CEF shareholders are provided stronger protections from other sources than the protections provided to shareholders of operating companies. Therefore, in addition to the significant concerns raised by the Proposals in the CEF context, we worry that a failure by the Commission promptly to disapprove these Proposals would raise the prospect of similar changes with respect to operating companies in the future.

Proposals' claim that eliminating the annual meeting requirement would not harm CEF investors, and thus be inconsistent with Exchange Act Section 6(b)(5), appears to be a mere assertion rather than a conclusion supported by well-specified reasoning. Indeed, as we now turn to explain, the exchanges' assertion is incorrect. The Proposals should be expected to have significant detrimental effects on CEF investor protection.

II. THE DETRIMENTAL EFFECTS OF APPROVING THE PROPOSALS

Having seen that the exchanges have failed to analyze how the elimination of the annual-meeting requirement would affect the interests of CEF investors, we turn now to provide that analysis. As we explain below, the analysis shows that the Proposals should be expected to have substantial detrimental effects on investor protection and the interests of CEF shareholders.[18]

A. The Challenge of Investor Protection in CEFs: The Absence of Exit

Any discussion of investor protection and corporate governance in CEFs should begin with a recognition of how CEFs differ from other vehicles investors can choose, like open-ended funds. Indeed, the Proposals note that exchanges' annual-meeting requirement does not apply to open-ended funds or exchange-traded funds (ETFs).[19] But as discussed below, investor protection of CEF investors presents challenges that differ from those in open-ended funds. Notably, although the Proposals discuss the longstanding lack of an annual-meeting requirement for open-ended funds, the Proposals say nothing about the fundamental investor-protection differences between open- and closed-end funds described below.

A key feature of open-ended funds and ETFs is investors' right to exit, or redeem their shares, at the net asset value (NAV) of those shares promptly.[20] As both financial economists and the SEC have recognized for decades, this exit right by itself provides substantial protection to investors in open-ended funds.[21] If the managers of an open-ended fund underperform due to

[18] This analysis draws, in part, on an independent expert report that one of us prepared in connection with certain litigation related to CEF activism. *See Eaton Vance Senior Income Trust* v. *Saba Capital Master Fund, Ltd.*, No. 2084CV01533-BLS2 (Mass. Sup. Ct. Dept. 2021).

[19] *See, e.g.*, NYSE Proposal, *supra* note 1, 89 Fed. Reg. 56447 & n.4 ("Section 302.00 of the [NYSE Listing] Manual exempts from th[e annual-meeting requirement] companies whose only securities listed on [NYSE are] securities listed pursuant to" rules governing open-ended funds and exchange-traded funds (ETFs)).

[20] For especially thoughtful discussion of the importance of exit rights in mutual funds, see John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1233 & n.6 (2014) (citing Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961 (2010), Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 WASH. U. L.Q. 1017 (2005), and John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2010)). Professor Morley's work famously places funds in the framework of the economists Albert Hirschmann and Oliver Williamson. *See* Morley, *supra*, at 1246 (citing ALBERT O. HIRSCHMANN, EXIT, VOICE, AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1970) and OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985)).

[21] For example, in 2019 the SEC voted to approve, with the support of then-Commissioner Jackson, a rule streamlining the operation of certain ETFs. U.S. Sec. & Exch. Comm'n, Final Rule, Exchange Traded Funds, Rel. No. IC-33646, 2019 WL 4727253 (Sept. 25, 2019) [hereinafter, SEC ETF Rule]. The Commission explained that the SEC has long "relied on th[e] close tie between what retail investors pay (or receive) in the secondary market and [an] ETF's approximate NAV to find that [certain] required exemptions [for ETFs] are necessary or appropriate in

incompetence, opportunism, or otherwise, investors can protect themselves from bearing the costs of that underperformance by exiting at NAV.

Furthermore, investor protection is served by the *ex ante* incentive effects of shareholders' power to redeem their shares. The possibility that underperformance will produce redemptions gives fund managers powerful incentives to avoid underperformance in the first place.[22] Incumbents in open-ended funds and ETFs are deterred from opportunism at any given point by the fear that it would lead to redemptions. Indeed, there is significant empirical evidence that underperformance in open-end funds is followed by fund outflows.[23]

By contrast, closed-end funds do not provide shareholders the right to redeem shares at NAV at a time of investors' choosing.[24] Indeed, a large fraction of existing CEFs provide investors with no right to deem their shares *ever*.[25] Whereas the lack of redemption power could facilitate investment strategies that could be disrupted by redemptions, the lack of exit power removes an important protective mechanism and also makes investors more vulnerable to incompetence or opportunism. Even if incumbents persist in acting incompetently or opportunistically for lengthy periods, the capital in a CEF can be "stuck" indefinitely—and gradually eroded over time due to the persistence of these problems.

Of course, CEF investors have the power to sell their shares on the exchange on which the fund is trading. But the option to sell on the market does not protect individual CEF investors or the aggregate capital in the fund from fully bearing the costs of incumbent incompetence or opportunism. Consider, for example, a CEF whose incumbent managers underperform peers by 2% a year due to such incompetence or opportunism. In this case, given investors' lack of exit rights, the fund would continue to erode at 2% a year, compared to peer funds. As a result, individual investors who sell their shares on the market would not be able to escape bearing the costs of future underperformance. The reason, of course, is that the market price at which investors could sell their shares would include a steep discount to NAV reflecting the expectation that the fund would underperform by 2% annually in future years.

Thus, the Commission and financial economists have long understood that, while the power to redeem shares at NAV at any time protects investors in open-end funds and ETFs from having to continue to bear the costs of underperforming managers, CEF investors, lacking such

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the public interest and consistent with the purposes fairly intended by the policy and provisions of" the ICA. *See id*. at *5 (citing Henry T.C. Hu & John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. CAL. L. REV. 839 (2018)).

[22] Morley, *supra* note 20, at 1249-50 (concluding that "redeeming and switching to a fund that operates in the competitive portion of the market can almost always produce at least as much benefit as voting" (citing, *inter alia*, John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151 (2007)).

[23] *See, e.g.*, Susan E.K. Christoffersen, David K. Musto & Russ Wermers, *Investor Flows to Asset Managers: Causes and Consequences*, 6 ANN. REV. FIN. ECON. 289 (2014) (surveying this literature).

[24] Morley, *supra* note 20, at 1268 "Investors apparently find closed-end funds' limited exit rights so troubling that very few investors are willing to pay full price for closed-end fund shares anymore.").

[25] INVESTMENT COMPANY INSTITUTE, 2024 FACT BOOK: U.S. CLOSED-END FUNDS 1, 68-79 (2024) (finding that, at the end of 2023, total assets of "traditional" CEFs, which allow no redemption at NAV at any point in time, was $249 billion).

power, need another protective mechanism to address such problems.[26] The critical mechanism in this respect, which the NYSE proposal threatens to undermine, is the power of CEF shareholders to elect new directors.

B. The Election Mechanism

Since CEF investors lack exit power that would enable them to escape the consequences of incompetent or opportunistic incumbent managers, a key investor protection mechanism for CEF investors is the power to elect new directors—and, thus, discontinue incumbents' services. That is: instead of an "exit" mechanism, CEF investors are protected by a "voice" mechanism that enables them to change the identity and future direction of their fund's management. This mechanism operates by enabling CEF investors to vote in shareholder meetings to elect new directors who can discontinue incumbent managers' services.[27]

In a CEF, if incumbent managers operate in an incompetent or opportunistic way, once the fund's shareholders come to recognize this underperformance, these shareholders have the power to bring about change. Specifically, they have the power to elect in subsequent shareholder meetings new directors to fill the seats of incumbents whose term expires.

The literature provides empirical evidence, which the Proposals ignore, that such activity does indeed take place. Perhaps the best-known study, by Professors Bradley, Brav, Goldstein and Jiang, provides a "comprehensive empirical study" of many instances over time in which CEF incumbents were challenged by shareholders, including many instances in which incumbents were replaced.[28] The evidence shows that the mechanism we describe operates especially effectively vis-à-vis underperforming funds: challengers tend to target closed-end funds at relatively large discounts to NAV, and avoid funds that do not.[29]

The considered mechanism benefits CEF investors in two important ways. The first is a direct effect. In cases in which a fund is led by incompetent or opportunistic leaders, the mechanism can directly improve matters for CEF investors by replacing existing fund directors

[26] *See, e.g.*, SEC ETF Rule, *supra* note 21, at *5 ("Investors also have come to expect that an ETF's market price will maintain a close tie to the ETF's NAV per share, which may lead some investors to view ETFs or some types of ETFs more favorably than similar closed-end funds."); Morley, *supra* note 20, at Coates & Hubbard, *supra* note 22, at 10 ("That redeemable shares facilitate competition among [open-end funds at ETFs] is consistent with the fact that, in the market for pooled investments, open-end companies with redeemable shares have largely displaced closed-end funds, which lack redeemable shares . . . . From an economic perspective, the protection of redeemable shares [at NAV] is arguably more important in supporting competition [for fund investors] than any other aspect of the current legal framework" governing funds).

[27] In CEFs even this mechanism is limited by the fact that, "[u]nlike in boards in ordinary companies, boards in closed-end funds cannot back up their control by threatening to hire and fire individual senior executives. Closed-end fund boards can only hire and fire *entire management companies*. This is costly and difficult, since firing an entire management company entails resetting all of a fund's administrative operations and business strategy." (citing as an example, Dividend & Income Fund, Inc., *Investment Management Agreement* (March 8, 2011), *at* http://www.sec.gov/Archives/edgar/data/1059213/000105921311000025/dniinvestmentmanage2011.htm (giving a CEF no ability to hire and fire individual employees of a CEF's corporate adviser entity)).

[28] Michael Bradley, Alon Brav, Itay Goldstein & Wei Jiang, *Activist Arbitrage: A Study of Open-Ending Attempts of Closed-End Funds*, 95 J. FIN. ECON. 1, 2 (2010).

[29] *Id.* at 2 ("We find that activist arbitrage has substantial impact on CEF discounts. . . . A key variable that guides activist arbitrageurs in choosing which fund to target is the fund's discount from its NAV.").

with directors who would address such problems. As Professors Bradley, Brav, Goldstein and Jiang explain, this effect can "reduce the discount of the targeted funds by more than 10 percentage points on average." This effect, they find, is "substantial, given that discounts of targeted CEFs are around 20% of NAV in the years before" shareholders intervene.

The second effect is indirect—but no less important. The fear of potential replacement gives incumbent CEF directors significant incentives. These incumbents recognize that, to minimize or altogether eliminate the possibility of replacement, the best approach would be to avoid underperformance altogether. As the financial-economics literature has explained:

> [Shareholder interventions] affect[] CEF discounts not only via the direct effect on the targeted funds, but also via an indirect anticipation effect. That is, some [CEF] funds' discounts may decrease without any noticeable [shareholder] attacks, simply because the attacks are anticipated in the future. Hence, the [direct] effect of [shareholder interventions] on discounts should be considered a lower bound.[30]

For these important benefits for CEF investors to be generated, however, it is necessary for the mechanism described above to operate adequately. Such adequate operation, in turn, requires the existence of shareholder meetings at which CEF investors can elect new directors. The existence of those meetings, of course, is exactly what the Proposals threaten.

C. Expected Effects on the Frequency of Annual Meetings

Because the CEF investor-protection mechanism of director elections critically depends on votes being held at shareholder meetings, the existence and frequency of such meetings is an important determinant of investor protection. But the premise of the Proposals, and of the CEF practitioners who support the Proposals, is that, if the Proposals were to be approved, there will remain no legal requirement for CEFs to hold any shareholder meetings.

For example, law firms describing the Proposals have argued to their clients that neither the Investment Company Act nor state law requires CEFs to hold annual meetings. In a Memorandum to Clients issued days after the Proposals were announced, one law firm said:

> Neither the Investment Company Act of 1940[,] under which CEFs are registered, nor any other federal securities laws . . . require CEFs to hold annual shareholder meetings. The laws of Delaware, Maryland, and Massachusetts, where a vast majority of CEFs are organized, also do not require CEFs to hold annual shareholder meetings. The rules of the national securities exchanges on which listed CEFs trade, such as NYSE and Nasdaq, are currently the *only authority requiring CEFs to hold annual shareholder meetings*.[31]

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[30] *Id.*

[31] Ropes & Gray LLP, Alert, *NYSE Proposes Rule Changes to Exempt Registered Closed-End Funds from Requirement to Hold Annual Meetings* (June 12, 2024) (emphasis added). We note that this firm was among those claiming that there is "no legal or factual basis" to "the assertion that SPACs [can be] investment companies," a claim the firm continues to advertise on its website. Ropes & Gray LLP, Alert, *Over 60 of the Nation's Leading Law*

Thus, under the legal premise underlying the Proposals and held by counsel who advise CEFs, if the Proposals are approved CEFs would be free to proceed indefinitely without a shareholder meeting.[32] If that premise is correct and the Proposals are approved, when the term of a current CEF director ends, it would not be possible for any alternative candidate to put themselves up for election to the director's board seat—and, in the absence of an election, the current director would remain in place as a holdout director. Thus, for as long as the existing directors of a CEF wished to remain in place, they would be able to perpetuate themselves in office—no matter how little support they might have among shareholders.

We note that, in cases currently being litigated, certain funds argue that the 1940 Act should be viewed as placing no limits on the length of time during which holdout directors may serve.[33] We believe that there is a good basis for the courts to reject this argument. However, the Proposals do not suggest that the Commission's review of the Proposals should be contingent on how this issue is resolved in the courts; indeed, the NYSE Proposal does not mention it at all. Accordingly, in evaluating whether the Proposals should be approved, the Commission should consider the scenario in which the question is resolved in the fashion CEFs and their lawyers (although not these authors) say it should: that the ICA does not impose an independent constraint on CEFs' freedom to hold no shareholder meetings, and be governed by holdover directors, in perpetuity.

Firms Respond to Investment Company Act Lawsuits Targeting the SPAC Industry (August 27, 2021). Professor John Coates, a former General Counsel of the Commission, later described the "main significance" of this claim as to show "how invested major law firms and their clients became" in the special-purpose acquisition company bubble of 2021. John Coates, *SPAC Law and Myths* (Working Paper February 11, 2022), at 38. The Staff knows how that turned out. *See* U.S. Sec. & Exch. Comm'n, Final Rule, *Special Purpose Acquisition Companies, Shell Companies, and Projections*, Rel. No. 33-11265, 89 Fed. Reg. 14158, 14164 (Feb. 26, 2024) ("[B]ecause . . . a SPAC could be an investment company at any stage of its operations," the Commission "provid[ed] guidance as to the type of activities that would likely raise serious questions about a SPAC's status as an investment company").

We note this history because the SEC recently initiated proceedings on a NYSE proposal to allow a SPAC to be listed for forty-two months after its initial listing date, see U.S. Sec. & Exch. Comm'n, Rel. Act. No. 99906, 89 Fed. Reg. 25291 (April 4, 2024), noting that NYSE's proposal raised "concerns under the Investment Company Act of 1940" that, despite the Commission's guidance on this subject, were ignored in the NYSE proposal. U.S. Sec. & Exch. Comm'n, Self-Regulatory Organizations, NYSE, Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Amend Section 102.06 of the NYSE Listed Company Manual to Provide that a Special Purpose Acquisition Company Can Remain Listed Until Forty-Two Months from its Original Listing Date, Rel. No. 34-100480 (July 9, 2024).

[32] The CBOE Proposal expressly claims that "the 1940 Act does not require a Shareholder meeting," citing for that proposition the ICA's legislative history and a generation-old no-action letter. CBOE Proposal, *supra* note 1, 74 Fed. Reg. 57492 & n.7 (citing Investment Trusts and Investment Companies: Hearings on H.R. 10065 Before the House Subcomm. on Interstate and Foreign Comm., 76th Cong., 3d Sess. 43 (1940); U.S. Sec. & Exch. Comm'n, John Nuveen & Co., Inc., No-Action Letter (Nov. 18, 1986)). In the years since that letter, the Commission has expressly noted that "[c]losed-end funds registered on national securities exchanges . . . are required to hold an annual meeting to elect directors under the rules of the exchanges." U.S. Sec. & Exch. Comm'n, Proposed Rule, Role of Independent Directors of Investment Companies, Rel. No. 42007 n. 149 (October 1999).

[33] *See Saba Capital Master Fund, Ltd.* v. *BlackRock ESG Capital Allocation Term Trust*, No. 24-cv-01701, 2024 WL 3162935 (S.D.N.Y. June 25, 2024), at * 9; *see also Eaton Vance*. Like the CBOE Proposal, counsel for the funds in those cases have relied upon previous Staff no-action letters to contend that "[n]othing in the 1940 Act requires that a fund's directors be elected by the fund's public shareholders." Memorandum of Law in Support of Defendants' Motion to Dismiss *in Saba Capital Master Fund, Ltd.* v. *BlackRock ESG Capital Allocation Term Trust*, No. 24-cv-01701 (filed April 3, 2024), at 16 & n.14.

D. Expected Entrenchment Costs

Suppose, then, that CEFs could go on for indefinite or very long periods of time with no shareholder meetings—and with CEF directors, no matter how negatively viewed by investors, facing no prospect of being replaced. In that state of affairs, the election mechanism described above would no longer adequately perform its valuable functions. With no meetings at which rival directors could be elected, existing directors should be expected to become entrenched.[34]

Such entrenchment would produce two types of entrenchment costs, each representing elimination of one of the two types of benefits that the election mechanism currently produces. One such entrenchment cost would result from elimination of the potential benefit from replacement of incompetent or opportunistic directors. Such replacement produces, in each case in which it occurs, a direct benefit from future improvement of how fund directors function and perform; the entrenchment brought about by the Proposals would eliminate those direct benefits.

The second type of expected entrenchment costs would consist of costs resulting of the weakening of the *ex ante* incentives of CEF directors to pursue investor interests more generally. The reason is that a major source of such incentives—the election mechanism—would be eliminated. With shareholder meetings eliminated, CEF directors would no longer expect that increasingly poor performance would result in increased odds of losing their board seat to a new director. Accordingly, incumbent CEF directors' incentives to avoid or address incompetence or opportunism would be significantly weakened.

Existing empirical studies on CEF activism support the above analysis of entrenchment costs. As noted earlier, the empirical study by Bradley, Brav, Goldstein and Jiang shows that, consistent with activism providing incentives to improve fund performance, activists tend to target funds that are poorly performing and to avoid targeting funds that are not; and that shareholder activism in CEFs "affects CEF discounts not only via the direct effect on the targeted funds, but also via an indirect anticipation effect." This evidence is the basis for the researchers' conclusion that activism "is an important activity undertaken by market participants to eliminate the difference between market prices and potential security values."[35]

The significant costs of entrenchment in CEFs are also shown in a study by Matthew Souther.[36] The Souther study analyzes the effects of takeover defenses used in CEFs, such as classified boards, obstacles to removal of directors prior to the end of their terms, and exclusive board control of bylaws. The study documents that these takeover defenses are associated with higher private benefits for CEF insiders. In particular, the study documents that a greater number of takeover defenses is associated with:

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[34] As in any organizational form, a discussion of investor protection in CEFs requires paying attention to agency problems and agency costs. The finance literature has long recognized the presence of agency costs in CEFs. *See, e.g.*, Michael J. Barclay, Clifford G. Holderness & Jeffrey Pontiff, *Private Benefits from Block Ownership and Discounts on Closed-End Funds*, 33 J. FIN. ECON. 263 (1993); Jonathan B. Berk & Richard Stanton, *Managerial Ability*, *Compensation, and the Closed-End Fund Discount*, 62 J. FIN. 529 (2007); Martin Cherkes, Jacob Sagi & Richard Stanton, *A Liquidity-Based Theory of Closed-End Funds*, 22 REV. FIN. STUD. 1 (2009).

[35] Bradley, Brav, Goldstein & Jiang, *supra* note 28, at 2.

[36] Matthew Souther, *The Effects of Takeover Defenses: Evidence from Closed-End Funds*, 119 J. FIN. ECON. 420, 421 (2016).

> [H]igher . . . expense ratios, director compensation levels, and managerial advisor fees . . . . [t]he evidence . . . consistently shows that takeover defenses have a negative effect on [CEF] firm value.[37]

These results highlight, the study concludes, "the financial benefits that directors receive from the use of takeover defenses," and that defenses "allow [CEF fund insiders] to extract benefits from [CEF] shareholders."[38]

It is important to note that, whereas the takeover defenses examined in the Souther study make it somewhat more difficult to elect rival directors, the entrenching effect of these defenses is considerably weaker than the expected entrenchment effect of the Proposals, which could operate to preclude the election of rival directors altogether. For that reason, the entrenchment effects of the Proposals should be expected to be considerably larger in magnitude than the substantial entrenchment effects of the takeover defenses documented in the Souther study.

Notably, the Proposals do not at all consider the expected effects of the removal of the annual-meeting requirement for CEFs on shareholders' ability to elect new directors in underperforming CEFs, the expected entrenchment costs that would result, and the empirical evidence on this subject. The Proposals' complete silence on these issues is in stark contrast to the Commission's approach in its recent consideration of proposed rules to tighten disclosure requirements for activist investors targeting operating companies.

In that process, the SEC's examination of the proposed rules recognized and discussed at length the potential effects of such proposals on shareholder activism vis-à-vis underperforming targets and the extent to which entrenchment would result, the importance of all available empirical evidence on that subject, and the value of obtaining additional empirical evidence to enable an informed policy decision.[39] Notably, that consideration led the SEC to adopt rules that, though contestable and contested, have not produced litigation.[40]

The failure of the exchanges to conduct any examination of the entrenchment effects of the Proposals reflects a fundamental flaw in the process that put these Proposals before the SEC. We return to that subject in Part IV below.

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[37] *Id.* at 421.

[38] *Id.* at 422.

[39] U.S. Sec. & Exch. Comm'n, Final Rule, Modernization of Beneficial Ownership Reporting, Rel. No. 34-98704, 88 Fed. Reg. 76896, 76908 (November 7, 2023) (analyzing "concern" that the proposed rules might "deprive issuers and their shareholders of the positive effects of" "activism," "thereby increasing management entrenchment and reducing shareholder engagement and corporate accountability"); *see also id.*, 88 Fed. Reg. 76905 ("[A] number of commenters expressed concerns that the proposed amendments would increase management entrenchment and reduce shareholder engagement and corporate accountability.").

[40] Commissioner Peirce, for example, dissented from the finalization of these rules. *See* U.S. Sec. & Exch. Comm'n, Commissioner Hester Peirce, Appropriating Appropriate Asymmetries: Statement on Modernization of Beneficial Ownership Reporting Rule (October 10, 2023). We were among the researchers whose work served as a basis of the Commissioner's dissent from the proposed rule. *See* U.S. Sec. & Exch. Comm'n, Commissioner Hester Peirce, Dissenting Statement on Proposed Modernization of Beneficial Ownership Reporting (February 10, 2022) ("My former colleague Rob Jackson, along with Professor Lucian Bebchuk, advised the Commission in 2012 that [the proposal could not be] justified by an appeal to general intuition").

E. Frustration of Longstanding Investor Expectations

Finally, the Proposals say nothing about another serious concern regarding the effects they would have if approved. As we have stressed, the annual-meeting requirement for CEFs has been in place for decades—and thus presumably when most existing CEFs first went public. Furthermore, we are unaware of any significant public discussion of consideration by any exchange of dropping this longstanding requirement.[41] Thus, investors who bought CEF shares during this period could reasonably have expected that annual meetings, and the accountability they produce, would be part of the governance structures of the CEFs in which they invested.

The sudden removal of the annual-meeting requirement by the exchanges would thus frustrate the longstanding expectations that CEF investors reasonably held about the governance structure of their CEFs. Essentially, if the Proposals are approved, these investors would find themselves holding a security with an altered governance structure that would have a lower economic value. Note that the amount of funds invested in CEFs is very large indeed; that CEF investors include some four million individual retail investors; and that those retail investors are disproportionately likely to be retirees.[42] Thus, frustrating the expectations of the investors in the large number of existing CEFs raises serious investor-protection concerns indeed.

To be sure, it might be argued that, if these investors do not like the change, they are free to sell their shares upon learning about the Proposals' approval. However, for the same reason that the option to sell CEF shares on the market does not protect CEF investors from bearing the costs of expected future CEF underperformance, the option to sell on the market does not protect CEF investors from bearing the costs of an exchange rule change they did not anticipate.

The reason is that these investors would be selling, and would be receiving the value of, securities in a CEF devoid of an important protective mechanism. Thus, the option of selling on the market would not enable CEF investors to retain the value of the securities with a protective mechanism in which they invested—and which they reasonably expected to continue holding.

III. DEVELOPMENTS OVER TIME.

In this Part, we start with a simple but important question: Given that exchange-listed CEFs have been subject to annual-meeting requirements for decades, have there been any changes in circumstances that might lead the exchanges to seek a sudden change now? In Section A below, we explain that the answer to this question is no: the Proposals do not identify, and we are not aware of, any changes for CEFs or their investors that might justify the Proposals.

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[41] As we explain in further detail below, fund industry advocates have included the elimination of CEFs' annual-meeting requirements among their policy requests for more than twenty years. U.S. Sec. & Exch. Comm'n, Proxy Voting Roundtable: Broker Proxy Voting, Statement of Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute (2007), at 9 ("For many years, the Institute and its closed-end fund members have believed [NYSE's annual shareholder meeting requirement for CEFs] is unnecessary because closed-end funds are already subject to voting requirements under the Investment Company Act."). Since that time, throughout both Republican and Democratic presidential administrations, we are unaware of any serious effort, at the SEC or any self-regulatory organization, actually to implement this request, in part because evidence supporting it is so wanting.

[42] INVESTMENT COMPANY INSTITUTE, *supra* note 25, at 79 & fig. 5.8.

Thus, in Section B, we consider an alternative explanation to the possibility that circumstances have changed: that the Proposals represent another attempt, in a long line of attempts, to insulate CEF directors from accountability to investors. Recent judicial decisions blocked one such attempt in recent years, and we expect the Proposals have similarly little basis in existing law.

A. What Changes Over Time Might Justify the Proposals?

To begin, we note that the Proposals' principal justification for removing CEFs' annual-meeting requirements is the ICA provisions protecting CEF investors. But these statutory protections have been in place since 1940, more than 80 years ago. The exchanges have nevertheless required CEF annual meetings for many decades. Those statutory protections thus certainly cannot be regarded as a change to market circumstances justifying or explaining the exchanges' current move.

The exchanges might argue, however, that the significance of annual meetings has recently changed in light of claims by CEF representatives that "[p]ressure from activist investors [has] surged" in CEFs, such that "increased shareholder activism has impacted the market" in a negative fashion.[43] However, CEF activism has existed for decades; such activism is hardly a new development that requires dropping old rules due to new circumstances. Indeed, a well-known academic study of CEF activism by Michael Bradley, Alon Brav, Itay Goldstein, and Wei Jiang documented that CEF activism "ha[d] become quite common since the mid-1990s," and "[i]n the peak years of 1999 and 2002, about 30% of the funds in [their] sample were targets" of activism.[44]

Finally, it might be claimed that, putting aside the potential use of some shareholder meetings for control challenges, annual meetings have simply become substantially more expensive in terms of transaction costs. In such a case, the potential savings from eliminating such meetings might have increased substantially in size, justifying the Proposals. However, the exchanges do not make such a claim in the Proposals themselves, and it is doubtful that they could plausibly support such a claim. Indeed, the increase over time in the use of electronic delivery of proxy statements seems to have operated to reduce, rather than increase, the costs of holding an annual meeting.[45]

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[43] INVESTMENT COMPANY INSTITUTE, CLOSED-END FUND ACTIVISM SURGES, SHOWS NEED FOR CONGRESSIONAL ACTION (May 14, 2024).

[44] Michael Bradley, Alon Brav, Itay Goldstein & Wei Jiang, *Activist Arbitrage: A Study of Open-Ending Attempts of Closed-End Funds*, 95 J. FIN. ECON. 1, 2 (2010). In this respect, we note that advocates' claims relating to the supposed rise in the frequency of CEF activism are based on selected timeframes that justify those claims. *Compare id. with* INVESTMENT COMPANY INSTITUTE, *supra* note 43 (limiting this claim to a specified time period).

[45] We note that the Proposals include no information about meeting costs that would permit careful analysis of any such claims. Making the Proposals without such evidence runs counter to the Commission's longstanding approach in this area. For example, in 1958 the Commission retained the Securities Research Unit of the Wharton School of Finance and Commerce of the University of Pennsylvania to conduct a fact-finding survey regarding the costs of mutual-fund management. U.S. Sec. & Exch. Comm'n, Investment Company Act Rel. No. 2,729, 1958 WL 5755 (June 13, 19583), and Wharton produced *A Study of Mutual Funds*, H.R. Rep. No. 2274, 87th Cong., 2d Sess. (1962). That study later served as the basis for the 1970 amendments to the Investment Company Act.

Thus, we are unaware of any changes in market conditions that warrant the proposed elimination of the longstanding requirement that CEFs hold annual meetings. In light of the exchanges' sudden interest in changing a decades-old rule without any apparent changes in circumstances that could justify such a change, one might expect the Proposals at least to discuss this question. But both Proposals are silent on that subject. In the next Section, we discuss an alternative possible explanation for the emergence of these Proposals at this time.

B. Alternative Explanations for the Proposals

The making of the Proposals at this time might be viewed as less sudden and surprising if viewed in the context of the decade-long effort by CEFs and their advocates to entrench incumbent fund managers and insulate them from control challenges. If the Proposals were to be approved, they would contribute greatly to this longstanding, and thus far unsuccessful, effort.

Because the accountability and disciplining effects of appropriate governance structures can be costly to incumbent CEF managers, CEFs over time have expended significant effort to adopt and expand "anti-takeover" arrangements that could block shareholder efforts to challenge incumbents' control. Among the arrangements that CEFs have adopted are staggered board elections, poison pills, and so-called "continuing director" provisions.[46]

One entrenchment device that CEFs have attempted to use is control share acquisition statutes, which prevent challengers of CEF incumbents from voting any shares they hold in excess of 10% of shares outstanding. However, in 2010, while Mary Schapiro served as Chair, the Staff of the Division of Investment Management issued a detailed no-action letter explaining that a CEF opting into a control-share statute "would be acting in a manner inconsistent with Section 18(i) of the Investment Company Act."[47]

Later, during the Chairmanship of Jay Clayton, the Investment Company Institute urged the SEC to rescind the Boulder Letter and open the door to the use of control-share arrangements.[48] Less than three months after the Investment Company Institute made that

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[46] For a discussion of such arrangements, *see, e.g.*, INVESTMENT COMPANY INSTITUTE, RECOMMENDATIONS REGARDING THE AVAILABILITY OF CLOSED-END FUND TAKEOVER DEFENSES 15-16 (March 2020). For an empirical analysis of such defenses and their consequences for investors, see Souther, *supra* note 36, at 421 ("Defenses are associated with lower fund market values, weaker reactions to activist 13D filings, and higher compensation levels for both fund managers and directors.").

[47] *See* Ltr. to Boulder Total Return Fund, Inc. from Kyle R. Ahlgren, Senior Counsel, U.S. Sec. & Exch. Comm'n Div. of Investment Management, File No. 811-07390 (Nov. 15, 2010) [hereinafter, the "Boulder Letter"]. The Boulder Letter built upon a well-known 2009 speech by Andrew Donahue, then the Director of the Division of Investment Management and, later, the Commission's Chief of Staff. *See* Andrew J. Donahue, Director, U.S. Sec. & Exch. Comm'n Div. of Investment Management, Keynote Address at the Independent Directors Council, Investment Company Directors' Conference (Amelia Island, Florida, 2009) ("I submit that the adoption of a poison pill, or restricting the rights of a 'dissident' shareholder even where the state law authorizes it, may be inconsistent with federal law and not in the best interest of the fund and its shareholders.").

[48] Investment Company Institute, ICI Urges the SEC to Strengthen the Ability of Closed-End Funds to Defend Against Activist Campaigns (March 12, 2020) ("Specifically, ICI asked the Commission to withdraw [the Boulder Letter], and issue guidance clarifying that closed-end funds can employ common takeover defenses.").

request, the Commission obliged, withdrawing the Boulder Letter in a brief statement in 2020.[49]

The Commission's action was soon the subject of litigation. A federal judge in the Southern District of New York ruled that, in "contrast[] with the Boulder Letter, which examined the Investment Company Act in detail and explained why [CEFs] opting into control share statutes violated [the ICA's] plain language," the 2020 statement "contain[ed] no legal analysis" and "did not provide any persuasive authority" for the SEC's position.[50]

The Second Circuit saw the case as similarly straightforward, affirming and writing that the "language [of the ICA] is plain and unambiguous" in requiring the conclusion that a CEF opting into a control-share statute had violated the statute. Tellingly, the Second Circuit responded to the Investment Company Institute's argument that the ICA"s "policy and purposes" provisions compelled the opposite outcome by concluding that, "[e]ven if [the ICA] were so ambiguous as to make Congress's policy considerations determinative," they would lean" against interpretations that entrench incumbent fund management.[51]

Thus, if approved, the Proposals would reflect a substantial acceleration of prior initiatives seemingly designed to insulate incumbent CEF directors from control challenges. As discussed in Part III above, the Proposals could well have a significantly detrimental effect on the ability of CEF investors to challenge underperforming incumbent managers.

Indeed, in terms of the magnitude of the chilling effect on such challenges, the Proposals could well have an even more significant effect than the control share arrangements that the federal courts recently invalidated and the Investment Company Institute earlier enabled by urging rescission of the Boulder Letter. Under a control share arrangement, a challenger's removing underperforming incumbents would still be possible—even if more difficult. By contrast, to the extent that the Proposals are approved and enable CEFs to avoid shareholder meetings altogether, enabling incumbents to remain in power as holdover directors, they would erect even more formidable impediments to control challenges to underperforming incumbents.

Notably, there is one way in which the Proposals differ from the Investment Company Institute's 2020 effort to have the Boulder Letter rescinded. In its 2020 initiative, the ICI's

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[49] U.S. Sec. & Exch. Comm'n, Div. of Investment Management, Staff Statement: Control Share Acquisition Statutes (May 27, 2020) ("The staff would not recommend enforcement action to the Commission against a closed-end fund under Section 18(i) of the [Investment Company] Act for opting in and triggering a control share statute if the decision to do so by the board of the fund was taken with reasonable care on a basis consistent with other applicable duties and laws and the duty to the fund and its shareholders generally.").

[50] *Saba Capital CEF Opportunities 1, Ltd.* v. *Nuveen Floating Rate Income Fund*, No. 21-cv-327, 2022 WL 493554 (S.D.N.Y. 2022) (Oetken, J.). In later litigation, Judge Rakoff concluded, with respect to further arguments fund managers made in support of the claim that the ICA permitted the use of control-share statutes, that the "fatal flaw in th[ose] argument[s was] rather easy to spot." *Saba Capital Master Fund, Ltd.* v. *BlackRock Municipal Income Fund, Inc.*, 2024 WL 43344 (S.D.N.Y. Jan. 4, 2024).

[51] *Saba Capital CEF Opportunities 1, Ltd.* v. *Nuveen Floating Rate Income Fund*, 88 F.4th 103, 120 (2d Cir. 2023) ("Congress passed the ICA to . . . correct and prevent certain abusive practices in the management of investment companies for the protection of persons who put up money to be invested by such companies on their behalf, i.e., the shareholders. These corrections were enacted for the benefit of investors, not fund insiders, and passed primarily to correct the abuses of self-dealing which led to . . . fantastic abuses of trust by investment company management." (internal quotation marks, alterations and citations omitted)).

arguments focused on the alleged costs of having incumbents subject to control challenges by shareholder activists, and accordingly the economic benefits of insulating incumbents from such activism.[52] By contrast, although the Proposals would have a strong entrenchment effect—indeed, we think, a stronger effect than a control share arrangement could produce—the Proposals do not even mention their expected effect on control challenges and CEF activism.

Rather than arguing that control challenges are harmful and that insulating incumbents would benefit investors, the Proposals justify elimination of the annual meeting requirement as simply being unnecessary given the other protections provided by an eighty-year-old statute. That reasoning does not come close to meeting the exchanges' burden under the SEC's Rules of Practice nor provide any basis in law or evidence on which the SEC could approve the Proposals.

IV. Flaws in the Process that Led to the Proposals.

In the preceding Part we have carried out an examination, which the exchanges have failed to conduct, of the effects that the Proposal would have on investor protection in CEFs. We have concluded that the Amendment should not be approved in light of its expected detrimental effects on CEF investors.

Before concluding, however, we wish to stress that, putting to one side the substantive problems with the Proposals, the process that led to the Proposals itself raises serious concerns. When an SRO proposes a change to its rules for Commission consideration, SEC rules require the SRO to:

- [D]emonstrate that a proposed rule change is consistent with the Exchange Act and the rules . . . issued thereunder that are applicable to the [SRO; the] burden to demonstrate [this] is on the SRO that proposed the rule change[;]

- [D]escribe the reasons for adopting the proposed rule change, any problems the proposed rule change is intended to address, the manner in which the proposed rule change will operate to resolve these problems, the manner in which the rule change will affect various persons . . . and any significant problems known to the [SRO] that persons affected are likely to have in complying with the proposed rule change;

- [E]xplain why the proposed rule change is consistent with the requirements of the [Exchange] Act . . . A mere assertion that the proposed rule change is consistent with these requirements is not sufficient; and

[52] Indeed, one of us coauthored a study cited in the Investment Company Institute's advocacy materials. Investment Company Institute, *supra* note 46, at 14 & n.46 (citing Martijn Cremers, Robert J. Jackson, Jr. & John Morley, *The Value of Takeover Defenses: Evidence from Exogenous Shocks to Closed-End Mutual Funds* (Eur. Corp. Gov. Inst. Working Paper 2016), at 21-22 ("closed end fund investors *liked* the poison pill")). As the Second Circuit later explained, a "poison-pill provision" is characterized by a "key distinction" for ICA purposes: it "affected investors' *economic* interests by differentiating their ability to purchase discounted shares," "not . . . the ability to vote the shares they owned." *Nuveen*, 88 F.4th at 119 (emphasis in original). That study invited empirical analysis of the effects of CEF defenses such as the poison pill. But even observers open to the possibility that those effects can be beneficial do not think these Proposals justified by the evidence.

- [D]escr[ibe] the proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements [that is all] sufficiently detailed and specific to support an affirmative [SEC] finding.[53]

It is patently clear that the Proposals utterly fail to satisfy these requirements. For one thing, as we have explained, the Proposals state only that the SROs "believe[] that the proposed change" is "consistent with" Section 6(b) of the Act, "because it is designed to do" the things described in Section 6(b). But the Commission has been clear that a "mere assertion that the proposed rule change is consistent with these requirements is not sufficient."[54] It is hard to see how the Proposals are consistent with SROs' statutory obligations when proposing rule changes.

Moreover, rather than demonstrate and explain the reasons for the exchanges' conclusion that the Proposals would not harm investor protection, the SROs' filings merely assert this to be the case. The Proposals offer no analysis of the effects of eliminating CEF annual meetings on investors, and they ignore substantial empirical work documenting such potential effects.

The Proposals also assert, without more, that the annual-meeting requirement is made unnecessary by existing ICA protections. Neither SRO explains why the ICA's protections, which have existed since 1940, make annual-meeting requirements; neither explains why, if that is true, the annual-meeting requirement has existed alongside the ICA protections for decades; and neither identifies any change in circumstances justifying the Proposals' argument.[55]

The SROs' filings similarly fail to analyze the effects of the Proposals on individual investors, CEFs, and shareholder activism targeting underperforming CEFs. The SEC's Form 19b-4 requires analysis of "the manner in which the rule change will affect various" market participants. We therefore believe that the SROs were obligated, when advancing the Proposals, to consider their effects on investors, funds, and CEF shareholder activism. As noted above, the Proposals do not consider those questions at all, and they patently do not consider them in a manner "sufficiently detailed and specific to support an affirmative Commission finding."

Equally concerning is the SROs' failure to identify or take into account the existing empirical evidence on this subject—or to identify or seek any additional empirical information that could improve the exchanges', and the Commission's, analysis of the Proposals' effects. In light of the empirical studies that directly shed light on this subject, the SRO's omission of any reference to that evidence is hard to reconcile with their obligations under the *Rules of Practice*.

Finally, we note that the Proposals fail to analyze, from a legal or empirical perspective, how long CEFs will be able to proceed without holding any shareholder meeting. We believe that the Exchange Act, and the *Rules of Practice*, required the exchanges to make clear their

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[53] U.S. SEC. & EXCH. COMM'N, GENERAL INSTRUCTIONS FOR FORM 19B-4 (effective June 10, 2013); COMMISSION RULE OF PRACTICE 700(B)(3), 17 C.F.R. § 201.700.

[54] GENERAL INSTRUCTIONS FOR FORM 19B-4, *supra* note 55.

[55] We note that both Proposals simply repeat the decades-old assertion of the Investment Company Institute that the annual-meeting requirement "is unnecessary because closed-end funds are already subject to voting requirements under the Investment Company Act." Statement of Paul Schott Stevens, *supra* note 41, at 9.

view of the governing law and its implications—and whether the exchanges believe that, in the absence of annual shareholder meetings, CEF holdout directors would be able to remain on a CEF's board indefinitely.

We worry that Commission Staff with limited resources are being asked to contend with SRO filings, like the Proposals, that do not reflect real effort to comply with SRO obligations under the Exchange Act and Form 19b-4. It is one thing for an SRO to advance proposed rule changes upon advocates' request, as NYSE in particular has done in some cases.[56] But it is another for an SRO to do so on the slim basis on which these Proposals are placed before the Commission. The Exchange Act and Form 19b-4 require SROs to do more than refer to an eighty-year-old statute, and paste the text of Exchange Act Section 6(b) into a filing, before suggesting to the Commission that a change of the Proposals' magnitude is warranted. This is especially the case here because the Proposals themselves create substantial uncertainty about shareholders' governance rights at CEFs. That alone can be expected to be costly for the millions of individuals invested in CEFs.

In sum, SRO filings such as the Proposals create costly uncertainty, consume precious SEC resources, and raise questions about SROs' capacity to protect investors. These aspects of the Proposals by themselves warrant prompt Commission disapproval of the Proposals. Such disapprovals would also provide a useful reminder to SROs of their obligations to investors, and to the Commission, when proposing rule changes.

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For the reasons given above, our analysis indicates that the Proposals are seriously flawed as a matter of law, economics, and logic, and the case for SEC disapproval is strong. If we can be of assistance to the Commission or the Staff in any way, please do not hesitate to contact us. Professor Bebchuk may be reached at bebchuk@law.harvard.edu or (617) 495-3138, and Professor Jackson may be reached at robert.j.jackson@nyu.edu or (914) 819-7527.

Very truly yours,

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[56] For one recent example, see U.S. Sec. & Exch. Comm'n, NYSE, Order Instituting Proceedings, *supra* note 31. For another, consider the Commission's order instituting proceedings on a later-withdrawn NYSE proposal to permit the listing of SPAC subscription warrants, U.S. Sec. & Exch. Comm'n, Self-Regulatory Organizations, NYSE, Notice of Withdrawal of Proposed Rule Change, as Modified by Amendment No. 2, to Adopt Listing Standards for Subscription Warrants Issued by a Company Organized Solely for the Purpose of Identifying an Acquisition Target, Rel. No. 34-94810, 87 Fed. Reg. 26384 (May 4, 2022).