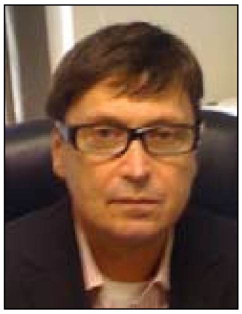

Dissident Conference Provides Glimpse Into the Next Proxy Season

Interview with Warren Antler, Managing Director, Closed-End Funds for The Altman Group

The Altman Group is a leading proxy solicitation and corporate governance consulting firm in the United States and winner of two TOPS Awards as the highest rated proxy solicitation firm. For more information about The Altman Group, visit their website at www.altmangroup.com.

The New Year ushers in a fresh proxy season for closed-end funds. Warren Antler of the proxy solicitation firm The Altman Group is always on top of happenings in the industry as they relate to shareholder voting at annual meetings. After attending the **Investor Activist Conference 2012** on January 23, 2012, we caught up with him to find out what he learned at the event.

CG: Thanks for giving us some of your time, Warren. I understand you participated in the conference. What was your role and what issues dominated the discussion?

WA: I sat on a panel entitled, "Exploring Closed-End Fund Activism" with the two leading activists, Phil Goldstein of Bulldog Investors and Art Lipson of Western Investment. Even though I was not the moderator I was able to ask Mr. Goldstein and Mr. Lipson questions on topics that I felt were important to understanding what 2012 will bring.

The first topic addressed was how not to negotiate a settlement agreement. Mr. Goldstein used the example of **SunAmerica Focused Alpha Growth Fund** (FGF) and the **SunAmerica Alpha Large Cap Fund** (FGI). He felt that the management and directors of the funds used an excessive amount of time to come to an agreement on a liquidity event for the two funds. By the time a solution was announced, the activists and shareholder base supporting the activists, were no longer interested in an agreement and the funds were, instead, forced to reorganize. Both funds have since open-ended.

Mr. Lipson commented on how he would change his future settlement agreements. He indicated that he would not include the fund complex's other funds in any settlement agreements. He felt that this takes too many funds out of play.

Mr. Goldstein added that he would continue asking for agreements of shorter durations on disclosed settlements.

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Warren Antler
The Altman Group

CG: I recall that during 2010 FGF and FGI conducted tender offers for up to 30% and 25% of their outstanding shares, respectively. In spite of such a significant tenders, dissident pressure persisted.

We have noticed that the number of settlement agreements has increased in recent years. This had the effect of avoiding some proxy fights and delaying others. Do you expect that trend to continue or did you get the impression that a combative proxy season will ensue this year?

WA: Art Lipson compared a proxy fight to a divorce. Both sides can either agree to an amicable divorce or they can dig in their heels and it can become a hostile and expensive ordeal.

Mr. Lipson recommended that funds that may be looking to settle with more than one activist should do so separately, as it is almost impossible to get two groups and the fund to agree on a settlement that pleases all sides.

Both panelists agreed that 2012 should be a repeat of 2011, which featured several fights but also many settlements.

They expect to support the same types of shareholder proposals they backed in 2011: declassification of boards, termination of investment advisor agreements, plurality voting for directors in contested elections, with tenders offers and discount management plans high on their list of ways to combat persistently wide discounts.

CG: Any insight into what type of fund targets the activists may focus on?

WA: Four criteria were mentioned as factors that make a fund a target for activism:

1. A persistent, wide discount to net asset value.
2. Is management honoring the discount-narrowing measures indicated in the original prospectus?
3. What is the composition of the shareholder base as it impacts the level of support dissident actions can be expected to receive?
4. The type of fund management: Mr. Goldstein indicated that he would rather target a large fund complex which would be more inclined to give up a fund, rather than a small complex that is more likely to fight tooth and nail not to lose a single fund.

[Mr. Goldstein] "estimated that with pending liquidations, open-endings and tender offers, as well as upcoming ARPs redemptions, activists will have approximtely $400 to $500 million for investment in closed-end funds."

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Mr. Lipson added that his strategy is to accumulate up to 9.9% of the outstanding shares, being careful not to cross the 10% threshold, as long as he has the hope of coming to an agreement with the fund.

CG: I see, because the 10% threshold would technically make him an "insider" by virtue of his shareholding and subject him to short-swing rules, requiring his group to disgorge any profits to the fund for holdings closed out in less than a six month period.

WA: Incidentally, I asked Mr. Goldstein to give me an approximate amount of money the activists might have available to invest in closed-end funds during 2012. He estimated that with pending liquidations, open-endings and tender offers, as well as upcoming ARPs redemptions, activists will have approximately $400 to $500 million for investment in closed-end funds.

CG: That could be quite a war chest! Many thanks for your time and insight, Warren.

ISS Invites Funds to Make Their Case

One of the most closely watched issues during the last few proxy seasons was the election of directors by ARPs shareholders—in both contested and even uncontested elections!

Preferred shareholders are entitled to elect two directors to the board, voting separately as a class. Over the past few years, several activist groups that hold illiquid ARPs purchased at deep discounts to par value in the secondary market have initiated proxy contests. They have issued their own proxies, nominating candidates for the preferred share-elected posts and typically also presenting proposals related to redeeming the ARPs. Redemptions at or near par value would provide an attractive windfall profit to these investors.

Less active, but holding the bulk of remaining outstanding ARPs, are settling firms which were required by regulators to buy the ARPs back from their clients at par value following the onset of the liquidity crisis for the shares, in February 2008. Settling firms hold blocks of closed-end fund issued ARPs large enough to single-handedly elect or prevent election of the dissident candidates. If the dissidents are able to obtain the settling firms' vote, they can win a seat on the board—but there is a wrinkle.

Regulatory accommodation has created an unusual requirement that a third party determine how to vote the settling firms' largest blocks of ARPs shareholdings, in most cases resulting in a situation where that third party is actually the one that can dictate the result of the election. A description of the background and details of the special Voting Protocol that created this situation is presented in the box on page 17.

Institutional Shareholder Services (ISS) is the third-party firm called upon to make the voting recommendations on behalf of settling firms. ISS' stated policy with regard to voting on directors in **uncontested elections** included the option to recommend that shareholders "do not vote" rather than "with-hold" support, "as a more effective means to send a message to preferred directors that have not been acting in the best interests of ARPS holders." That quote is from ISS' 2010 ARPS CEF Policy as presented at the *Investment Company Closed-End Fund Conference* in November, 2010, and reproduced with permission in the March, 2011 issue of this report.

Under that policy, ISS issued numerous "do not vote" recommendations during 2010 and 2011 in uncontested elections, frustrating quorums and preventing the election of ARPs directors. The result was that dozens of directors have been "held over," remaining in office until the next election—many will be voted on again this year.

We asked Alex Pulisic, who is responsible for formulating closed-end fund recommendations at ISS, if we should expect the same scenario this year. He told us that although he evaluates directors based on quantitative measures, such as how the group's ARPs redemptions, to date, compare to industry averages, qualitative measures often can take precedence. He noted that in contested elections it is quite common for funds to make a presentation to ISS of their position, but not as common in uncontested elections. He stated, "We invite the funds to come and talk to us, even if there are only uncontested issues on the ballot." He indicated that if ISS has a better idea of what actions the board has been considering or the progress of their efforts, it can be factored into their recommendation.

A growing number of fund groups are working on redemptions behind the scenes. Some have made public their efforts to seek replacement leverage and redeem their ARPs even though they have not yet been able to implement the redemptions. For instance, last month **DNP Select Income Fund** (DNP) and **Duff & Phelps Utility and Corporate Bond Trust** (DUC) disclosed that their charter provisions had hindered refinancing efforts and that they will be seeking shareholder approval at the upcoming meeting to amend their charters in order to pursue such efforts. Other funds have offered liquidity events, but still have ARPs outstanding. Most recently, the two Federated municipal funds conducted tender offers for up to 100% of their outstanding ARPs at 95% of par value. Even after extending the deals, neither fund could obtain universal participation. **Federated Premier Intermediate Municipal Fund** (FPT) still has 25% and **Federated Premier Municipal Income Fund** (FMN) still has 33% of its originally outstanding ARPs outstanding following completion of the offer.

The new ISS position may prompt funds to increase the flow of information related to progress on their ARPs refinancings and redemptions.

Review of Auction Rate Preferred Share Voting Protocol for Settling Firms

In the wake of the ARPs liquidity crisis and investor complaints of improper sales practices, some banks/brokers that sold ARPs reached settlements with regulators. Under these settlements, the institutions bought back ARPs from clients to whom they were sold at par value. Settling firms are now the largest shareholders of closed-end fund issued ARPs.

Some regulatory issues stood in the way of the settling firms fulfilling their agreements to buy back ARPs. To clarify regulatory treatment and establish ground rules, the firms asked the SEC for exemptive relief paving the way for the buy backs to proceed:

Auction Rate Securities-Global Exemptive Relief and a subsequent supplement, *Auction Rate Securities – Investment Management Supplement to Global Relief Request* address technical issues related to settling firms buying back ARPs sold to their retail and certain institutional customers. The no-action letter provides that a settling broker holding a 25% or greater stake in a fund's outstanding ARPs, that would be considered an affiliated person of the fund solely because of the ARPs acquired pursuant to the terms of the settlement, will not be considered an affiliate providing that the settling firm implements a specified *Voting Protocol*.

Under the *Voting Protocol*, the settling firm arranges to "vote its shares of such preferred stock as directed by an independent third party (such as … a proxy adviser) when voting on (1) the election of directors to be elected by the holders of such preferred stock, voting as a class…and (2) matters requiring approval by the vote of a majority of such preferred stock, voting as a class."

NYSE Clarification Causes Initial Confusion: Exchange Issues Memo on the Use of Broker Non-Votes for Certain Types of Corporate Governance Proposals

On January 25, 2012 the New York Stock Exchange announced changes in the interpretation of Rule 452, reducing the types of instances in which "broker non-votes" can be cast on behalf of clients in proxy votes. While release of the Memo showing the details of the changes caused some initial questions, it seems that the new guidelines will not have a meaningful impact on closed-end funds. At the heart of the confusion was a list of corporate governance topics that are typically the subjects of shareholder proposals.

"Broker non-votes," also called the "routine vote" or "broker discretionary vote," refer to shares held in street name for which the beneficial owner fails to return the proxy card. Although these shares have technically not been "voted" at all, to help companies obtain a quorum and prevent unnecessary proxy solicitation costs, the shares can be counted as "present" and brokers are permitted to "vote" the shares on certain *routine matters*. In such instances, the exchange specifically indicates that "brokers may vote."

The recent announcement will narrow the scope of corporate governance matters that are considered to be routine for broker non-vote purposes. Memo Number 12-4 from the NYSE Euronext to all NYSE and NYSE Amex Equities Members and Member Organizations states, "proposals that the Exchange previous ruled as "Broker May Vote" including, for example, proposals to de-stagger the boards of directors, majority voting in the election of directors, eliminating supermajority voting requirements, providing for the use of consents, providing rights to call a special meeting, and certain types of anti-takeover provisions overrides, that are included on proxy statements going forward will be treated as 'Broker May Not Vote' matters."

We asked Warren Antler of the proxy soliciation firm The Altman Group how the industry might be affected. He noted that "for closed-end funds, most of the types or proposals listed in the Memo are already deemed to be non-routine, and therefore broker non-votes could not be used even before the changes." In fact, to be routine, the items would have to be proposed by the fund rather than as a shareholder proposal or included on a dissident proxy. It is quite unlikely that management would be the proponent of the specific types of agenda items listed.

Furthermore, any agenda item that is *contested* is automatically considered to be non-routine. For example, for closed-end funds, the uncontested election of directors is considered routine, and broker non-votes are allowed (investment companies registered under the Investment Company Act of 1940 specifically enjoy this type of treatment by explicit exemption). However, if a dissident group issues its own proxy statement for the meeting, presenting a competing slate of candidates for board posts, the election is considered to be non-routine, and broker votes are not permitted.

Mr. Antler clarified that the Memo was not intended to overturn any specific language in the rule (indeed, the list of "examples" in the Memo covers areas not specifically addressed in the current rule). Thus because there is a specfic exemption written into Rule 452 concerning director elections for investment companies, the NYSE's new interpretation will not prohibit discretionary broker votes for uncontested director elections.