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SEC Proposes Proxy Voting and Say-on-Pay Voting Disclosure Requirements for Funds and Institutional Investment Managers

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On September 29, 2021, the Securities and Exchange Commission (SEC) proposed new proxy voting disclosure requirements (the Proposal) for registered investment companies (funds)¹ and for institutional investment managers (managers) subject to reporting under Section 13(f) of the Securities Exchange Act of 1934 (the Exchange Act).² Under the Proposal, funds would, among other things, be required to categorize their voting records by standardized proposal types on Form N-PX, disclose the number of shares that were voted (or, if not known, the number of shares that were instructed to be voted) as well as the number of shares held by the funds that were loaned out on the record date and not recalled for voting, and post voting-related information on their websites. Similarly, managers would be required to disclose on Form N-PX their voting records regarding executive compensation and “golden parachute” arrangements. The new requirements for managers would implement the provisions of Section 14A of the Exchange Act adopted by Congress in 2010 under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).

The Proposal was the first proposed rule-making issued by the SEC under Chairman Gary Gensler and highlights the Chairman’s focus on the

shareholder proxy process as well as on completing outstanding implementation requirements under the Dodd-Frank Act. The Commissioners voted 4-1 in favor of the Proposal, with Commissioner Hester Peirce dissenting.³

The SEC’s focus on proxy voting and shareholder governance rights continued throughout the fall with two other rule makings. In November 2021, the SEC adopted final rules requiring parties in a contested election to use universal proxy cards that include all director nominees presented for election at a shareholder meeting. Under the new rules, shareholders must be provided with the ability to vote by proxy for their preferred combination of board candidates, as they do when voting in person.⁴ The universal proxy rules became effective January 31, 2022. The SEC also proposed amendments to the current proxy rules governing proxy voting advice for the stated purpose of enhancing proxy advisory firms’ ability to deliver independent proxy voting advice to their clients in a timely manner.⁵ If adopted as proposed, these rules would rescind portions of rules adopted by the SEC during the prior administration in 2020. Viewed in tandem, the Proposal and the proxy voting rules and proposals evidence a strong theme by the current SEC of strengthening the role of shareholders in corporate governance.

Background to the Proposal

The SEC adopted Form N-PX in 2003 to improve transparency and enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies. Funds are currently required to file their proxy voting records on the Form annually. These reports are available to the public through the SEC's EDGAR system.⁶ The SEC stated that while the reporting has increased transparency, investors find it difficult to use the reports in their current form. The SEC also noted that current reports may give an incomplete picture of a fund's voting practices because the reports do not highlight which of the fund's securities were not voted because securities were out on loan on the applicable record date. The Proposal would address perceived shortcomings in the current fund reporting regime on Form N-PX.

The Proposal also would address rulemaking requirements under Exchange Act Section 14A. Section 14A requires public companies to hold non-binding shareholder votes regarding approval of executive compensation and "golden parachute" compensation arrangements, known as "say-on-pay votes." Companies must seek shareholder votes relating to: (1) approval of the compensation of its named executive officers; (2) the frequency of such votes, with the option of every one, two, or three years; and (3) approval of "golden parachute" compensation in connection with a merger or acquisition. Section 14A(d) provides disclosure requirements for managers on "say-on-pay votes" that the SEC is directed to adopt rules to implement.⁷ Although the SEC adopted rules in 2011 implementing the non-binding shareholder vote provisions of Section 14A,⁸ to date it has not adopted rules to implement the voting disclosure requirements set forth in Section 14A(d). The SEC proposed rules in 2010 to implement Section 14A(d), but the proposed rules were never finalized. The current Proposal builds on the 2010 proposal and addresses comments received in response to that proposal.

Funds' Reporting Obligations

Changes to Form N-PX

The SEC proposed changes to Form N-PX for the stated purpose of making the report more useful to investors.⁹ Most significant among the proposed changes is a requirement that matters on which the reporting person voted be reported under specified standardized categories and sub-categories and be reported in a designated order on the Form. The Proposing Release suggested a broad range of categories of matters to which votes attach including: board of directors, environmental or climate related, human rights or human capital, corporate governance, extraordinary transactions, compensation, political activities and shareholder rights.¹⁰ A reporting person would be required to reflect the person's voting record under each of the applicable categories in the required order. The purpose of requiring listing of the voting record under each applicable standardized category and designated order is to allow investors to follow voting on matters that are important to them and to facilitate comparison of voting by different funds (or managers, who, as discussed below, would also become subject to reporting on Form N-PX).¹¹ In relation to the desire to provide greater transparency to proxy voting, the SEC noted that investors have increased their focus on how funds vote on environmental, social, and governance-oriented matters (that is, ESG matters).¹²

Another important proposed change to the Form requirements is one that would require funds (and other reporting persons) to indicate the number of shares voted (or instructed to be cast) and the number of shares loaned and not recalled for voting. The intent of this proposed amendment is to reflect the effect of a fund's securities lending activities on its proxy voting and to provide context to the information provided about revenue from securities lending.¹³ The fund (or other reporting person) would be able to rely on its own records to determine the number of shares voted or instructed to be cast without seeking confirmation of this number.¹⁴

The proposed changes to Form N-PX also include the following:

- Proxy voting matters would be required to be described using the same language as used in the issuer's form of proxy, and each voting matter would be required to be listed in the same order as presented in an issuer's form of proxy.
- A fund that offers multiple series of shares would be required to organize its Form N-PX report so that it would provide its disclosures (including voting record) separately by series. It would also be required to list each series on the summary report.
- A new section on the cover page of Form N-PX would identify amendments to a previously filed report.
- Form N-PX would permit optional disclosure of additional information, either at the end of the cover page or, if it relates to a particular vote, following the required disclosure regarding that vote.
- Form N-PX would require funds (but not managers) to indicate whether matters proposed by security holders were proposals or counterproposals.
- Form N-PX would require a reporting person to indicate whether each vote was for or against management's recommendation.
- Reporting persons would be required to file Form N-PX reports in a custom XML language. The SEC indicated that this formatting should make it easier for reporting persons to prepare the filing and more useful to persons reading the report.¹⁵

Website Reporting

A fund would be required to post its voting record reflected in the fund's most recently filed report on Form N-PX on its website in a readable format as soon as reasonably practicable after filing. A fund would also be required to provide the

information upon request and provide an email address that an investor could use to obtain the fund's voting record.¹⁶ Proposed amendments to Forms N-1A, N-2 and N-3 would require a fund to disclose that its proxy voting record is publicly available on or through its website, available on request, free of charge and in "human-readable" form.

Managers' Reporting Obligations.

Scope

Under the Proposal, managers would become subject to reporting on Form N-PX regarding say-on-pay votes. In addition, the same as funds, managers would be required to report on their voting record whenever they have the ability to vote the security or direct the voting of the security. Managers would be deemed to have the ability to vote a security that was out on loan on the applicable record date but could have been recalled.¹⁷

Proposed Rule 14Ad-1 under the Exchange Act would require each person that is a manager to file Form N-PX to disclose how it voted proxies relating to say-on-pay matters.¹⁸ The Proposal would require managers to report votes required by Section 14A of the Exchange Act on the approval of executive compensation, the frequency of such executive compensation approval votes, and the approval of executive compensation that relates to an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all of an issuer's assets.¹⁹ Although supported by some commenters on the 2010 proposal, the SEC is not proposing a *de minimis* exception or proposing to limit the report to securities that have previously been disclosed on a manager's Form 13F.²⁰

Under the Proposal, exercise of voting power would be defined as the actual use of voting power to influence a voting decision, including the ability to influence how a third party votes a security. However, a manager would not be required to report a vote on say-on-pay matters if its voting decisions

are dictated by the client and the manager does not exercise any judgment in determining how to apply a client's voting policies or otherwise influence the client's voting decision. Similarly, a manager would not be required to report a vote if the client or lending agent determines whether to recall a loaned security without any involvement of the manager in the decision.²¹

In the case where a manager does not exercise voting power over any say-on-pay votes during a reporting period, the manager would still need to file Form N-PX and indicate that it had not exercised voting power over any say-on-pay votes during the reporting period.²²

Joint Reporting

The Proposing Release notes that multiple parties can have voting power over the same securities and that a manager could exercise voting power even if it is not the sole decision maker.²³ Proposed amendments to Form N-PX would permit joint reporting by managers of say-on-pay votes in a manner similar to how joint reporting is disclosed on Form 13F. Thus, to avoid duplicative reporting, a single manager may report say-on-pay votes in cases where multiple managers exercise voting power over a security. However, the managers could also choose to report separately.²⁴ Form N-PX would be amended to accommodate joint reporting, if elected.

Another proposed amendment would permit a fund to report its say-on-pay votes on behalf of a manager that exercises voting power over some or all of the fund's securities. If a manager's say-on-pay votes are reported by one or more funds over whose securities the manager exercises voting power or by one or more other managers, the non-reporting manager would be required to file a Form N-PX report that identifies each manager and fund reporting on its behalf.²⁵

Affiliates would also be permitted to file joint reports even if they do not exercise voting power over the same securities, which would allow affiliated

managers to report their votes at the holding company level.

In all cases, joint reporting would be optional. The reporting manager would identify the other manager(s) on whose behalf it is reporting and the securities over which each of the non-reporting managers exercises voting power. The other managers would file Form N-PX and identify the manager(s) or fund(s) that reported on their behalf.²⁶

Confidential Treatment

The information reported on Form N-PX generally is, and will remain, publicly available. Managers that file Form 13F are permitted to request confidential treatment with respect to one or more positions that they are required to report, subject to meeting certain conditions and following certain filing procedures set out in the instructions to Form 13F. Managers will similarly be permitted to request confidential treatment of information reported on Form N-PX. The SEC stated that its intent is to provide a similar opportunity to prevent confidential information that is protected from disclosure on Form 13F from being disclosed on Form N-PX.²⁷

The instructions proposed for Form N-PX would provide that persons requesting confidential treatment follow the same procedures prescribed for Form 13F confidential treatment requests. The Proposing Release states that any confidential treatment request would be required to provide enough factual support for the request, including a demonstration that the information is both customarily and actually kept private by the reporting person, and that release of this information could cause harm to the reporting person.²⁸ The SEC further states that filers should not seek confidential treatment "solely to prevent proxy voting information from being made public."²⁹

The SEC also noted that, since Form N-PX currently does not provide for confidential treatment, it would not be available for reports filed by funds.³⁰

Time of Reporting

The SEC did not propose any changes to the time frame currently used for fund reports on Form N-PX. Currently, funds file annually, no later than August 31 of each year, for the most recent 12-month period ended June 30. This same time frame is proposed for manager reports on Form N-PX.³¹

Compliance Dates

The SEC proposed compliance dates that would vary, depending on when the proposed amendments become effective. For example, if the amendments are effective six months before June 30 of a year, the first reports on amended Form N-PX would be required to be filed by the August 31 that follows the rule's effective date. For a fund, the first report on the amended form would disclose votes occurring at least six months after the effective date, while applicable votes occurring before this period could be reported under the current form requirements. A manager's requirement to report votes would begin six months after the effective date, since managers are not currently subject to Form N-PX reporting requirements.³²

If the amendments are not effective six months before June 30 of a year, funds and managers would be required to file their first reports on the amended Form N-PX by August 31 of the first complete reporting time frame following the effective date of the proposed rule. The first reports using the amended form would be required to disclose votes occurring six months after the effective date of the amendments and thereafter.³³

A manager would not be required to file a Form N-PX report for the 12-month period ending June 30 of the calendar year in which the manager's initial filing on Form 13F is due. Instead, the manager would be required to file a report on Form N-PX for the period ending June 30 for the calendar year following the manager's initial filing on Form 13F. A manager would not be required to file a report on Form N-PX with respect to any shareholder vote at a

meeting that occurs after September 30 of the calendar year in which the manager's final filing on Form 13F is due. Rather, the manager would file its report for the period July 1 through September 30 of the calendar year in which its final filing on Form 13F is due. This report would be due no later than March 1 of the immediately following calendar year.³⁴

Conclusion

The Proposal is significant as it reflects the priorities of this SEC in facilitating participation by money managers in corporate governance decisions (such as say-on-pay) and providing investors enhanced transparency to ensure that their managers are acting in a manner that is consistent with their own investment goals, including social investment goals. The Proposal also reflects a determination by Chairman Gensler, which is consistent with his implementation of Title VII of the Dodd-Frank Act while serving as Chairman of the Commodity Futures Trading Commission, to implement congressional directives, such as those contained in Section 14A (d) of the Exchange Act, which were adopted in connection with the Dodd-Frank Act but have yet to be put into place through regulation.

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NOTES

- ¹ The proposed requirements would apply to mutual funds and exchange-traded funds organized as open-end management investment companies, closed-end management investment companies as well as insurance company separate accounts organized as management investment companies that offer variable annuity contracts (which register on Form N-3). The Proposal would not apply to unit investment trusts, face amount certificate companies or small business investment companies registered on Form N-2.

² *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*, 1940 Act Release No. 34389 (Sep. 29, 2021), 86 FR 57478 (Oct. 15, 2021) (the Proposing Release).

³ Notably, Commissioner Peirce issued a statement regarding the Proposal, stating that she supported the SEC's proposing rules to implement statutorily required "say-on-pay" voting disclosures, but that she is concerned that the current and proposed Form N-PX disclosure requirements benefit activists rather than investors. As a result, she asked for comment as to whether the SEC should propose the complete withdrawal of all non-statutorily mandated voting disclosures, allow for presumptive confidentiality of votes, and emphasize that the SEC takes no position as to whether or not funds should vote. *See* Commissioner Hester M. Peirce, "Statement on Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers," Sept. 29, 2021.

⁴ *Universal Proxy*, Securities Exchange Act Release No. 93596 (Nov. 17, 2021) 86 FR 68330 (Dec. 1, 2021).

⁵ *Proxy Voting Advice*, Securities Exchange Act Release No. 93595 (Nov. 17, 2021), 86 FR 67383 (Nov. 26, 2021).

⁶ Proposing Release at 57478.

⁷ Section 14A(d) provides: Every institutional investment manager subject to section 78m(f) of this title shall report at least annually how it voted on any shareholder vote pursuant to subsections (a) and (b), unless such vote is otherwise required to be reported publicly by rule or regulation of the [SEC].

⁸ *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, SEC Rel. Nos. 33-9178; 34-63768 (Jan. 25, 2011), 76 FR 6010 (Feb. 2, 2011).

⁹ Funds currently are required to file their proxy voting records annually on Form N-PX for each matter relating to a portfolio security considered at any

shareholder meeting held during the reporting period on which the fund was entitled to vote.

¹⁰ The proposed requirement for reporting persons to categorize each vote was the subject of a number of comments by representatives of funds, investment advisers and others, with some suggesting that categorizing the votes would not be useful to investors, and some others suggesting alternative approaches to the SEC's proposed categories and sub-categories. *See, e.g.*, Letter from Susan Olson and Sarah A. Bessin, Investment Company Institute to Vanessa A. Countryman, SEC, dated Dec. 14, 2021 (recommending replacement of proposed categories and subcategories with smaller number of higher-level categories) (ICI Letter); Letter from Paul P. Andrews and Matt Orsagh, CFA Institute, and Jeff Mahoney, Council of Institutional Investors, to Vanessa A. Countryman, SEC, dated Dec. 14, 2021 (generally supporting higher-level categorization, but expressing concerns regarding proposed categorization framework, especially the proposed subcategories).

¹¹ Proposing Release at 57487.

¹² *Id.* at 57479.

¹³ *Id.* at 57480.

¹⁴ The SEC received a number of comments from the fund industry, from managers and other industry participants opposing the proposed requirement to disclose the number of shares not voted because they were on loan and not recalled. Several commenters expressed the view that the information would not be useful to investors, would be costly or impractical to obtain, or would tend to cast securities lending practices in a negative light without consideration of the benefits to investors. *See, e.g.*, ICI Letter, *supra* n.10; Letter from Gail C. Bernstein, Investment Advisor Association, to Vanessa A. Countryman, SEC, dated Dec. 14, 2021 (IAA Letter); Letter from Jennifer W. Han, Managed Funds Association, to Vanessa A. Countryman, SEC, dated Dec. 14, 2021 (MFA Letter); David B. Smith, Jr., Mutual Fund Directors Forum, to Vanessa A. Countryman, SEC, dated Dec. 14, 2021. Some commenters suggested that a better alternative would be for reporting persons to

- provide a narrative disclosure of their policies regarding the recall of securities on loan for voting purposes in Form N-PX or Form ADV. *See, e.g.*, ICI Letter, *supra*; IAA Letter, *supra*; MFA Letter, *supra*.
- ¹⁵ Proposing Release at 57495. Reports are currently filed in HTML or ASCII.
- ¹⁶ Inclusion of an email address is already required by Form N-2.
- ¹⁷ Proposing Release at 57483.
- ¹⁸ *Id.* at 57480.
- ¹⁹ *Id.* at 57482.
- ²⁰ *Id.* at 57484.
- ²¹ *Id.* at 57483.
- ²² *Id.* at 57485.
- ²³ *Id.* at 57482.
- ²⁴ *Id.* at 57492.
- ²⁵ *Id.* at 57492.
- ²⁶ *Id.* at 57493.
- ²⁷ *Id.* at 57498.
- ²⁸ *Id.*
- ²⁹ *Id.*
- ³⁰ *Id.* at 57499.
- ³¹ *Id.* at 57497.
- ³² *Id.* at 57500.
- ³³ *Id.* at 57500-57501.
- ³⁴ *Id.* at 57501.

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