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SEC's Controversial Fund Proxy Voting Disclosure Requirements Come into Play

By Gary O. Cohen

Last fall, the US Securities and Exchange Commission (SEC) adopted¹ rule and form amendments (amendments) requiring mutual funds, exchange-traded funds (ETFs), and certain other registered funds (together, funds) to report more details about their voting of portfolio company proxies.

The amendments apply to votes occurring on or after July 1, 2023. First reports on amended Form N-PX must be filed by August 31, 2024, covering the period of July 1, 2023 to June 30, 2024.²

The amendments, although highly technical, raise substantive issues that caused a split vote among the Commissioners.³ The Investment Company Institute supported⁴ many, but not all, of the amendments.

New Requirements

Essentially, the SEC amended reporting Form N-PX to require that funds disclose votes in a consistent manner and machine-readable format. SEC Chair Gary Gensler said that the rules “will allow investors to better understand and analyze how their funds and managers are voting on shares held on their behalf.”⁵

Specifically, the amendments require funds to:

- identify each voting matter as falling within one of 14 categories⁶ specified in the form;
- tie the description and order of voting matters to the issuer's proxy card;
- disclose (if applicable, by series) the number of shares that were voted (or abstained), how the shares were voted, and whether the vote was for or against management's recommendation;
- use a structured data language to make the filings easier to analyze; and
- provide their voting record on (or through) their websites and make the record available upon request free of charge.

Principal Controversies

The SEC adopted the amendments by a three-to-two vote⁷ along political party lines. Democrat Chair Gensler⁸ and Commissioners Caroline A. Crenshaw⁹ and Jaime Lizarraga¹⁰ voted for, and Republicans Hester M. Peirce¹¹ and Mark T. Uyeda¹² voted against, adoption. Each issued a written statement.

The industry is now approaching the proxy voting period that will be the first to be reported on under the amendments. So, it seems timely to recall the principal controversies among Commissioners over the amendments.

Need for Detailed Information

The SEC justified the need for more detailed proxy voting information on two policy grounds:

1. Funds own approximately 32 percent of the market capitalization of all US-issued equities outstanding. Therefore, funds “can influence the outcome of a wide variety of matters that companies submit to a shareholder vote, including matters related to governance, corporate actions, and shareholder proposals.”¹³
2. More than 45 percent of US households own fund shares. Therefore, “[d]ue to funds’ significant voting power and the effects of funds’ proxy voting practices on the actions of corporate issuers and the value of these issuers’ securities, investors have an interest in how funds vote.”¹⁴

More specifically, the SEC said that “[w]e are requiring this disclosure because providing the number of votes cast improves the transparency of fund and manager voting records and more effectively enables investors to monitor their funds’ and managers’ involvement in the governance activities of their investments.”¹⁵

Commissioner Peirce countered that “evidence that investors want such detailed [fund proxy voting] information is scant.”¹⁶ She bluntly opined that “detailed chronicling of votes will not benefit the average investor” and that certain amendments “will harm funds and fund investors.”¹⁷ She claimed that the persons who really “have an interest in the information” are “[t]hird parties with an interest in pressuring funds to vote in a particular way.”¹⁸ She predicted that the required information “may turn out to be less about reporting voting practices than it is about manipulating them.”¹⁹

Weighing Costs and Benefits

The SEC sloughed through a long discussion of the costs and benefits of the amendments.²⁰ The discussion acknowledged that “[t]he amendments to Form N-PX, Form N-1A, Form N-2, and Form N-3, will lead to some additional costs for funds” and that “[a]ny portion of these costs that is not borne by a fund’s adviser or other sponsor will ultimately be borne by the fund’s shareholders.”²¹

The SEC implicitly concluded that benefits of the amendments outweigh their costs.

Commissioner Peirce claimed that “[t]he Commission is too enthusiastic about the rule’s purported benefits to pay much attention to its costs.”²² She noted that funds would have to bear the cost of custodians’ and securities lending agents’ providing certain of the required information.²³ She also asked: “should fund investors be footing the bill to make it easier for third parties to assess funds’ voting patterns?”²⁴

Reporting Votes by Category

The SEC adopted “a requirement for reporting persons to select from specified, standardized categories to identify the subject matter of each reported proxy voting item.”²⁵ The stated rationale is that “the list of categories will be non-exclusive” and “[t]his approach will further aid investors in locating useful information by allowing them to identify multiple topics that may be of interest.”²⁶

Commissioner Peirce predicted that “[t]hese groupings will fail of their purpose because of the unavoidable level of subjectivity involved in classifying each voting topic.”²⁷ Her thinking was that “[r]ather than run the risk of being second-guessed by Exams, Enforcement, and third parties, funds likely will err on the side of caution and take the ‘All of the above’ approach.”²⁸

Affecting Behavior Through Disclosure

The SEC’s adopting release is titled, in relevant part, “*Enhanced* Reporting of Proxy Votes by Registered Management Investment Companies.”²⁹ The SEC’s adopting release uses the word “enhance,” “enhanced,” or “enhancement”³⁰ 23 times to describe various aspects of the new fund proxy voting disclosure requirements.

Commissioner Uyeda disagreed. He asserted that “[m]any of the provisions are not ‘enhancements,’ but substantial changes that appear to affect the behavior of funds and their investment

advisers.”³¹ He gave the example of the required “disclosure of the number of shares loaned and not recalled”³² for a fund to vote, discussed in the section of this article immediately below. He also gave the example of the required reporting by categories “relate[d] to environmental, social, and/or governance issues,” suggesting that the “‘enhancements’ are motivated not by investor protection, but by special interests.”³³

Commissioner Peirce said that such requirements will “serve the needs of third parties eager to pressure funds to vote their way.”³⁴

Voting Loaned Portfolio Securities

Perhaps the most controversial issue among the Commissioners was the amendment³⁵ requiring disclosure of the number of shares that a fund has loaned and not recalled for voting prior to the meeting’s record date.

As background, former Commissioner Allison Herren Lee, when she was Acting SEC Chair, raised questions of fiduciary duty in the context of fund proxy voting. She stated: “Fiduciaries should be mindful of these competing concerns so as not to risk undermining the foundation of how shareholders engage with corporate management to maximize the long-term value of their holdings. As much as deciding how to vote requires due diligence, deciding *not* to exercise voting rights requires equally careful consideration.”³⁶

The SEC’s adopting release provides funds with some solace regarding fiduciary duty. It states that “[t]here are legitimate reasons why an adviser or other reporting person may decide not to recall any loaned securities” and “[t]he disclosure requirement is not intended to change the analysis reporting persons may undertake currently as to whether to recall a loaned security, such as by creating pressure for reporting persons to programmatically recall lent shares, or to create a negative implication when a reporting person does not recall a loaned security in any given case.”³⁷ The SEC’s adopting release also states that “to the extent a reporting person believes

additional narrative information may be helpful for investors to understand fully a determination whether to recall a loaned security and mitigate any perceived negative implications of this reporting, the reporting person will have the option of providing additional information on Form N-PX as amended.”³⁸

Commissioner Uyeda questioned these statements. He asked: “Will funds recall their securities, despite the additive returns that securities lending programs can bring, to look ‘more responsible’ on their Form N-PX disclosures? Or will the lack of showing any shares on loan give rise to private litigation against the fund for forgoing the extra returns? In this regard, I share the significant concerns of commenters that such disclosure would not provide appropriate context. Moreover, will this impact price discovery by creating seasonal shortages in the markets for borrowed securities?”³⁹

Commissioner Peirce also doubted the statements in the SEC’s adopting release. She said: “Judging from the limited discussion accorded to the opportunity cost of recalling lent shares, the Commission does not seem to care much about the financial costs of voting. Many commenters expressed concern that mandating a disclosure of unrecalled securities, bereft of context and a discussion of consequences, will place significant pressure on managers to recall securities to avoid negative ESG ratings. Although the final rule allows managers to provide some context, the nudge to vote remains strong.”⁴⁰

Considering Public Comments

The SEC stated that “[t]he Commission received a number of comment letters on the 2021 proposal.”⁴¹ The SEC’s adopting release recited and addressed many of the substantive comments received and identified numerous comment letters by author’s name.

Nevertheless, Commissioner Uyeda expressed disappointment that the Staff failed to follow what

he said was the long-standing process of relying on, and providing the Commissioners with, a “detailed comment summary.”⁴² He stated that a “basic fundamental of good rulemaking is the preparation of a detailed comment summary” that categorizes “all relevant comments by specific subject matter to ensure that we have not overlooked any comments in the public file.”⁴³ He blamed the failure on “an apparent rush to approve this rulemaking” and complained that the failure “did not respect the important contributions of the 58 commenters, who have taken time and resources to contribute their perspectives.”⁴⁴ He complained that “[t]he decision not to prepare a detailed comment summary is simply unacceptable.”⁴⁵

Conclusion

The first proxy voting period for funds to report on amended Form N-PX begins July 1. The Commissioners expressed sharply different views and expectations when the SEC adopted the amendments last fall. Query to what extent the amendments will affect current industry behavior.

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NOTES

¹ *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*, Securities Act Release No. 11131, Exchange Act Release No. 96206, Investment Company Act Release No. 34745 (Nov. 2, 2022) [hereinafter SEC Adopting Release], available at <https://www.sec.gov/rules/final/2022/33-11131.pdf>. The SEC proposed the amendments in *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*, Exchange Act Release No. 93169, Investment Company Act Release No. 34389 (Sept. 29, 2021), available at <https://www.sec.gov/rules/proposed/2021/34-93169.pdf>.

The amendments also require institutional investment managers to disclose how they voted on executive compensation, or so-called say-on-pay matters. This requirement fulfills one of the remaining rulemaking mandates under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act. This requirement is beyond the scope of this article, which speaks as of December 27, 2022.

² *Id.* at 72.

³ Commission Votes, Final Commission Votes for Agency Proceedings (Nov 2022), available at <https://www.sec.gov/about/commission-votes/annual/commission-votes-ap-2022.xml>. See *infra* n.7 and accompanying text.

⁴ See Letter from Susan Olson, General Counsel, and Sarah A. Bessin, Associate General Counsel, Investment Company Institute, to Vanessa A. Countryman, Secretary, SEC (Dec. 14, 2021), available at <https://www.sec.gov/comments/s7-11-21/s71121-20109499-263911.pdf>.

⁵ SEC, Press Release, SEC Adopts Rules to Enhance Proxy Voting Disclosure by Registered Investment Funds and Require Disclosure of “Say-on-Pay” Votes for Institutional Investment Managers (Nov. 2, 2022), available at <https://www.sec.gov/news/press-release/2022-198>.

- ⁶ The categories are: 1. Director Elections; 2. Section 14A; 3. Audit-Related; 4. Investment Company Matters; 5. Shareholder Rights and Defenses; 6. Extraordinary Transactions; 7. Capital Structure; 8. Compensation; 9. Corporate Governance; 10. Environment or Climate; 11. Human Rights or Human Capital/Workforce; 12. Diversity, Equity and Inclusion; 13. Other Social Issues; 14. Other. SEC Adopting Release, *supra* n.1, at 32-33.
- ⁷ See *supra* n.3. In the context of the section of this article titled “Principal Controversies,” references to the “SEC” means the three Commissioners who voted for the adoption of the amendments.
- ⁸ Gary Gensler, Statement on Final Amendments to Form N-PX (Nov. 2, 2022), available at <https://www.sec.gov/news/statement/gensler-statement-amendments-form-npx-110222>.
- ⁹ Caroline A. Crenshaw, Statement on Enhanced Reporting of Proxy Votes (Nov. 2, 2022) [hereinafter Commissioner Crenshaw Statement], available at <https://www.sec.gov/news/statement/crenshaw-statement-amendments-form-npx-110222>.
- ¹⁰ Jamie Lizarraga, Statement, Enhancing Fund Voting Reporting (Nov. 2, 2022), available at <https://www.sec.gov/news/statement/lizarraga-statement-amendments-form-npx-110222>.
- ¹¹ Hester M. Peirce, Voting Obsession: Statement on Final Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (Nov. 2, 2022) [hereinafter, Commissioner Peirce Statement], available at <https://www.sec.gov/news/statement/peirce-statement-amendments-form-npx-110222>.
- ¹² Mark T. Uyeda, Statement on the Final Rule: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (Nov. 2, 2022) [hereinafter Commissioner Uyeda Statement], available at <https://www.sec.gov/news/statement/uyeda-statement-amendments-form-npx-110222>.
- ¹³ SEC Adopting Release, *supra* n.1, at 5.
- ¹⁴ *Id.*
- ¹⁵ *Id.* at 34. Commissioner Crenshaw added that “the amendments will further act as a deterrent to fund advisers who might be motivated to vote corporate proxies based on their own economic or personal interests, rather than those of their investors.” Commissioner Crenshaw Statement, *supra* n.9 (citing SEC Adopting Release, *supra* n.1, at Sections IV.C.1.a and IV.C.2.).
- ¹⁶ Commissioner Peirce Statement, *supra* n.11.
- ¹⁷ *Id.*
- ¹⁸ *Id.*
- ¹⁹ *Id.*
- ²⁰ See SEC Adopting Release, *supra* n.1, Section IV.C.1. titled “Economic Analysis,” “Benefits and Costs,” “Amendments to Funds’ Reporting of Proxy Votes,” with the discussion of benefits beginning at 85 and the discussion of costs beginning at 96.
- ²¹ *Id.* at 96.
- ²² Commissioner Peirce Statement, *supra* n.11.
- ²³ *Id.*
- ²⁴ *Id.*
- ²⁵ SEC Adopting Release, *supra* n.1, at 28.
- ²⁶ *Id.* at 33.
- ²⁷ Commissioner Peirce Statement, *supra* n.11.
- ²⁸ *Id.*
- ²⁹ SEC Adopting Release, *supra* n.1, at 1 (emphasis added).
- ³⁰ *Id.* at 1, 6, 7, 13, 45, 48, 66, 77, 87, 91, 92, 95, 117, 118, 121, 124, 132, and 134.
- ³¹ Commissioner Uyeda Statement, *supra* n. 12.
- ³² *Id.*
- ³³ *Id.*
- ³⁴ Commissioner Peirce Statement, *supra* n.11.
- ³⁵ See SEC Adopting Release, *supra* n.1, at 38-45 and 101-106.
- ³⁶ Allison Herren Lee, Commissioner, SEC, Every Vote Counts: The Importance of Fund Voting and Disclosure, 2021 ICI Mutual Funds and Investment Management Conference (Mar. 17, 2021) (transcript available at <https://www.sec.gov/news/speech/lee-every-vote-counts>).

³⁷ SEC Adopting Release, *supra* n.1, at 42.

³⁸ *Id.* at 42-43 (footnotes omitted).

³⁹ Commissioner Uyeda Statement, *supra* n.12 (footnote omitted).

⁴⁰ Commissioner Peirce Statement, *supra* n.11 (footnote omitted).

⁴¹ SEC Adopting Release, *supra* n.1, at 8. The comment letters are available at <https://www.sec.gov/comments/s7-11-21/s71121.htm>.

⁴² Commissioner Uyeda Statement, *supra* n.12.

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*

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