

SEC ADOPTS FINAL RULE REQUIRING ADDITIONAL PROXY VOTING DISCLOSURES

Date: 14 November 2022

U.S. Asset Management and Investment Funds and Policy and Regulatory Alert

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On 2 November 2022, the U.S. Securities and Exchange Commission (SEC) voted 3–2, along party lines, to adopt a final rule and form amendments (together, the Final Rule) that would require additional disclosure on Form N-PX about a registered fund's proxy votes and require institutional investment managers to report on Form N-PX how they voted proxies regarding certain executive compensation matters (known as “say-on-pay” matters). The Final Rule is available [here](#). The SEC also published a corresponding Fact Sheet, which is available [here](#).

FORM N-PX AMENDMENTS

Form N-PX is an annual report on proxy voting records that many registered funds (e.g., mutual funds, exchange-traded funds) have been required to file with the SEC since 2003, pursuant to the Investment Company Act of 1940 and related regulations.

The Final Rule implements several changes to Form N-PX:

First, for proxy votes where a proxy card (also known as a “form of proxy”) is required to be filed with the SEC, the Final Rule now requires the disclosure on Form N-PX regarding such proxy votes to use the same language as the issuer's proxy card when identifying the matters on which a registered fund voted. Additionally, these registered funds are required to identify the proxy vote matters on Form N-PX in the same order as the proxy card.

Second, the Final Rule also requires registered funds to categorize their votes under its topic classification system, which prescribes the following 14 broad categories:

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

Though more categories, as well as subcategories, were previously proposed, they were ultimately not included in the Final Rule.

Third, the Final Rule standardizes the order of disclosure requirements. Additionally, the amended Form N-PX now requires each series of a multi-series trust to present its complete voting record separately from other series.

Fourth, the Final Rule amended Form N-PX to require registered funds to disclose the number of shares that were voted or instructed to be cast, as well as the number of shares loaned but not recalled and, therefore, not used to vote by the fund. Consequently, Form N-PX may prompt registered funds and institutional investment advisers to disclose not only their securities lending practices but also how such lending practices interplay with their proxy voting practices. Specifically, registered funds and institutional investment advisers will now have to weigh the benefits of participating in a securities lending arrangement against the benefits of being able to vote on a proxy matter. Moreover, funds that participate in securities lending arrangements will now have to determine if, or when, loaned securities should be recalled for proxy voting purposes.

Lastly, the Final Rule requires Form N-PX to be filed using Extensible Markup Language (XML), a structured data language that makes the form machine-readable.

NEW RULE 14AD-1 REQUIRES SAY-ON-PAY DISCLOSURES

The Final Rule also adopts new rule 14Ad-1, which requires institutional investment managers that are required to file reports under Section 13(f) of the Securities Exchange Act of 1934 (the Exchange Act) to report their say-on-pay votes on Form N-PX, which was mandated under Section 951 of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Section 13(f)(6)(A) of the Exchange Act defines “institutional investment manager” as “any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person.”¹ A 2020 FAQ from the SEC clarified that banks, including their trust departments, insurance companies, broker/dealers, trustees, and investment advisers that manage private accounts, mutual fund assets, or pension plan assets are institutional investment managers.² The FAQ further clarified that corporations and pension funds that manage their own investment portfolios are institutional investment managers but that natural persons who exercise investment discretion over their own accounts are not.³

New rule 14Ad-1 requires institutional investment managers to report say-on-pay votes on Form N-PX when voting on the approval of executive compensation, including “golden parachute” compensation in connection with a merger or acquisition, among other matters.⁴ The Final Rule provides a two-part test for determining whether an

institutional investment manager “exercised voting power” over a security and must therefore report a say-on-pay vote on Form N-PX:

15. The institutional investment manager has the power to vote, or direct the voting of, a security.

16. The institutional manager “exercises” this power to influence a voting decision for the security.

The Final Rule states that “voting power could exist or be exercised either directly or indirectly by way of a contract, arrangement, understanding, or relationship.”⁵ Further, the Final Rule states that “multiple parties could both have and exercise voting power over the same securities...even where [an institutional investment manager] is not the sole decision-maker.”⁶

Under such an analysis, institutional investment managers “exercise voting power when they vote or influence a vote using their own independent judgment,” including when an institutional investment manager “votes (or directs another party to vote) in accordance with the manager’s own guidelines or based on the manager’s own judgment, including exercising independent judgment or expertise to determine how a client’s voting policies should apply on a say-on-pay vote.”⁷ In fact, the Final Rule considers an institutional investment manager “determining not to vote on a say-on-pay matter” as it also exercising its voting power.⁸ In contrast, an institutional investment manager would “have no reporting obligation with respect to a voting decision that is entirely determined by its client or another party.”⁹

STATEMENTS BY SEC COMMISSIONERS

SEC Chair Gary Gensler, along with the two Democratic Commissioners, Caroline Crenshaw and Jaime Lizárraga, praised the rule for making Form N-PX “more useful, and more usable, to investors.”¹⁰ Commissioner Crenshaw added that the Final Rule would also “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.”¹¹ Chair Gensler’s statement on the Final Rule is available [here](#). Commissioner Crenshaw’s statement is available [here](#). Commissioner Lizárraga’s statement is available [here](#).

Republican Commissioner Hester Peirce stated that she supported implementing the Dodd-Frank mandate on say-on-pay reporting but was opposed to the expansion of proxy voting disclosure, recommending its complete elimination instead. She expressed skepticism of the Final Rule’s topic classification system ability to facilitate easier searches and increase comparability, predicting that the suggested “groupings will fail of their purpose because of the unavoidable level of subjectivity involved in classifying each voting topic.”¹² She stated that funds will not only “incur categorization costs and categorization anxiety” but will ultimately decide to “err on the side of caution and take the ‘all of the above’ approach” when it comes to categorization, in order to avoid “being second-guessed by Exams, Enforcement, and third parties.”¹³

Commissioner Mark Uyeda expressed concern that new rule 14Ad-1 could “prompt funds to recall their securities, despite the additive returns, to look ‘more responsible’ on their Form N-PX disclosures” or lead to an increase in “private litigation...for forgoing extra returns.”¹⁴

Commissioners Peirce and Uyeda also commented on the high costs to implement the Final Rule, asking if such costs were justified, especially when it did not seem that investors would benefit from, or even wanted, such disclosures. Commissioner Uyeda noted that the Final Rule did not provide any exemptions for small institutional investment managers despite the fact that “as of December 31, 2021, the [SEC] estimates that over half of

[institutional investment managers] exercise investment discretion over accounts with \$300 million or less in 13(f) securities, representing only 1% of the overall value of 13(f) positions reported.”¹⁵

Commissioner Peirce's statement is available [here](#). Commissioner Uyeda's statement is available [here](#).

NEXT STEPS

The Final Rule will be effective on 1 July 2024, meaning that Form N-PX filers will be required to file their first reports subject to the Final Rule by 31 August 2024 (covering the period of 1 July 2023 to 30 June 2024).¹⁶

More broadly speaking, Chair Gensler will continue to focus on implementing his ambitious regulatory agenda for the SEC, including the promulgation of final rules regarding environmental, social, and governance disclosures and digital assets, which has not been without controversy. Notably, Commissioner Uyeda included in his statements on the Final Rule more general criticisms of Chair Gensler's rule-making processes. For example, Commissioner Uyeda stated that he was “disappointed by the lack of a detailed comment summary” that came about due to the “rush to approve this rulemaking (sic).” He noted that “this also happened with the broker-dealer recordkeeping rule amendments a couple weeks ago” when he was provided “minimal detail on the comments received [that] did not even identify commenters by name.” Commissioner Uyeda stated that such a rushed process “did not respect the important contributions of the...commenters, who had taken time and resources to contribute their perspectives.” He asked: “If we are not willing to prepare a detailed comment summary for this rulemaking, then what does it mean for other rulemakings, such as climate disclosure and fund names[,] that have far larger numbers of public comments?”

The results of the midterm elections could have a significant impact on the future efficacy of Chair Gensler's regulatory agenda, as indicated by recent statements of many Republican Members of Congress. K&L Gates' Public Policy and Law professionals are ready to assist stakeholders as they engage in this critical policy dialogue.

ADDITIONAL INFORMATION

The Final Rule is not the only rulemaking that the SEC has done on proxy voting. Additional information on the 2020 amendments are available in our previous client alerts on the matter, which are available [here](#) (SEC Issues New Guidance for Investment Advisers on Proxy Voting, published 26 September 2019), [here](#) (SEC Proposes Rules to Curb Shareholder Proposals, Limit Proxy Voting, published 8 November 2019), [here](#) (SEC Adopts Final Rules on Proxy Voting Advice, published 27 July 2020), and [here](#) (Déjà Vu All Over Again: SEC Reverses 2020 Proxy Rules Changes and Proposes Shareholder Proposal Rule Changes, published 28 July 2022).

FOOTNOTES

¹ 15 U.S.C. § 78m(f)(6)(A).

² Sec. & Exch. Comm'n, Frequently Asked Questions About Form 13F (Feb. 24, 2020), <https://www.sec.gov/divisions/investment/13ffaq>.

³ *Id.*

⁴ Sec. & Exch. Comm'n, Final Rule, Enhanced Reporting of Proxy Votes by Registered Management Investment

Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (Nov. 2, 2022), 12.

⁵ *Id.* at 14.

⁶ *Id.*

⁷ *Id.* at 15.

⁸ *Id.*

⁹ *Id.*

¹⁰ Gary Gensler, Statement on Final Amendments to Form N-PX (Nov. 2, 2022), <https://www.sec.gov/news/statement/gensler-statement-amendments-form-npx-110222>.

¹¹ Caroline A. Crenshaw, Statement on Enhanced Reporting of Proxy Votes (Nov. 2, 2022), <https://www.sec.gov/news/statement/crenshaw-statement-amendments-form-npx-110222>.

¹² 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), <https://www.sec.gov/news/statement/peirce-statement-amendments-form-npx-110222>.

¹³ *Id.*

¹⁴ 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), <https://www.sec.gov/news/statement/uyeda-statement-amendments-form-npx-110222>.

¹⁵ *Id.*

¹⁶ Final Rule, at 71–72.

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