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Alert

SEC Proposes Rules Requiring 13F Filers to Disclose 'Say-on-Pay' Votes

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On Sept. 29, 2021, the Securities and Exchange Commission ("SEC") proposed Rule 14Ad-1, which would require institutional investment managers subject to section 13(f) reporting requirements to disclose their proxy votes on executive compensation matters, otherwise called "say-on-pay" votes, annually on Form N-PX. Currently, only registered funds are required to file Form N-PX.[1] Thus, if adopted, the rule would impose new filing requirements on many private fund managers.

The proposal is intended to implement Section 951 of Dodd-Frank. Indeed, the SEC proposed many of the changes over a decade ago, but that rule was never adopted.[2] The new rule proposal comes at a time when the SEC is heavily focused on enhanced reporting as part of its ambitious ESG agenda and directly addresses the "governance" component of ESG.

In numerous public statements, the SEC and its officials have expressed concern about a lack of ESG disclosure standards. Chairman Gary Gensler has called for a need to "see what's under the hood" of fund managers to test their ESG claims.[3]

The Proposed "Say-on-Pay" Voting Rule

Managers Required to File. The proposed rule would require institutional investment managers subject to the reporting requirements of section 13(f) of the Securities Exchange Act of 1934, as amended ("Exchange Act"),[4] to annually report their voting on executive compensation on Form N-PX. The reporting requirements of section 13(f) typically apply to a manager that exercises investment discretion over $100 million or more in securities designated as 13(f) securities regardless of whether or not the manager is registered with the SEC. The annual filing would be due by August 31 of each calendar year for the most recent 12-month period ended June 30.

Reportable Securities. Fund managers subject to the proposed reporting requirement would have to disclose their say-on-pay votes for any security over which they "exercise voting power" and is not limited to section 13(f) securities. The proposed rule defines voting power as "[having] the ability to vote the security or direct the voting of the security, including the ability to determine whether to vote the

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[1] "Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers," Exchange Act Release No. 34-93169 (Sept. 29, 2021), available here.

[2] *See id.* at 20 and 30. The SEC originally proposed adopting a different version of Rule 14Ad-1 on Nov. 18, 2010, but that rule was never adopted. The newly proposed Rule 14Ad-1 is substantially similar to the previously proposed rule, though it takes a different approach in determining when a vote must be reported.

[3] *See* Gensler, Gary, "Prepared Remarks Before the Principles for Responsible Investment 'Climate and Global Financial Markets' Webinar," SEC (July 28, 2021), available here.

[4] The proposed rule would not amend Form 13F, but, rather, would require firms required to file Form 13F also to file Form N-PX and disclose their votes on say-on-pay proposals.

security at all, or to recall a loaned security before a vote."[5] A fund manager "exercises" voting power when it "uses voting power to influence a voting decision."[6] Where a fund manager's voting decisions are determined entirely by a client or a third party, however, the manager would not be deemed to be exercising voting power over a security even if the fund manager is the party that carries out the actual vote.[7]

Reporting Requirements. Institutional investment managers would have to disclose the type of votes outlined in section 14A of the Exchange Act, which include votes on the approval of executive compensation, the frequency of executive compensation and executive compensation tied to a business combination or sale. The proposed disclosure would include (1) the number of shares voted (or instructed to be voted), (2) how those shares were voted (e.g., for, against proposal or abstain); and (3) the number of shares the reporting person loaned and did not recall (on the theory that this last requirement would help investors better understand how securities lending activities affect the voting practices of the reporting entity).[8]

Lending versus Voting. For loaned securities, the proposing release notes that investment advisers are fiduciaries with a duty to consider "the tradeoffs between continuing to keep securities on loan, or recalling loaned securities in order to vote."[9] The SEC rationalizes this proposed change as giving investors more transparency into whether a fund manager has decided to recall a loaned security to vote or essentially determined not to vote.[10] The disclosure would not, however, provide investors with transparency as to other fiduciary considerations, such as the relative benefits of recalling shares in order to vote, or choosing to forego voting in favor of the revenue from continuing to lend the shares.[11]

Lack of Exceptions. The proposed rule would apply to any position for which a fund manager has the power to vote[12] regardless of the size of the position (i.e., no de minimis threshold), the length of time the position was held or whether the manager actually voted.[13] Thus, even managers that have a policy of not voting or that have investment strategies not served by voting (such as algorithmic investment strategies) would still be required to report. Further, because the proposed rule does not include a de minimis exception and is not limited to section 13(f) securities, in certain instances, fund managers would have to publicly report positions on Form N-PX that are not required to be reported on Form 13F.

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[5] SEC, *supra* note 1, at 19-20.

[6] *See id*. at 15.

[7] *See id*. at 23.

[8] *See id.* at 43-44.

[9] *Id.* at 50.

[10] *Id*. at 51.

[11] *See* Roisman, Elad, "Statement on Proposed Changes to Asset Manager Proxy Voting Disclosure," SEC (Sept. 29, 2021), available here (requiring fund managers to disclose when they have not recalled loaned securities for voting is "ill-designed to communicate to investors the balancing that funds go through when considering how to maximize value for fund investors" since the disclosure would not indicate the fund 'manager's rationale for choosing to recall or not recall shares for voting). In this regard, the current proposal seems to represent a shift on this issue as compared to the prior administration's 2019 guidance to fund managers on proxy voting, which stated that an adviser may "refrain from proxy voting on behalf of a client when it has determined that refraining is in the best interest of the client," including, as an example, cases where "the adviser determines that the cost to the client of voting the proxy exceeds the expected benefit to the client." Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Investment Advisers Act Release No. 5325 (Aug. 21, 2019) at 11.

[12] SEC, *supra* note 1, at 27.

[13] *See id*. at 27-31.

The SEC has specifically invited comments from interested parties as to whether exceptions to reporting on Form N-PX should be implemented in the final rule and amendments.

Confidential Treatment. Similar to Form 13F, fund managers would be able to seek confidential treatment of certain or all the positions reported on their Form 13F under certain circumstances. Filers seeking confidential treatment would be "required to provide enough factual support for the [confidential treatment] 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."[14] The SEC cautioned that confidential treatment requests should not be used solely to shield voting from public disclosure. Instead, confidential treatment would be granted in "narrowly tailored circumstances" such as when a corresponding confidential treatment is granted on Form 13F.[15]

Consolidated Reporting. The proposed Form N-PX amendments would allow consolidated reporting under some circumstances. The proposed amendments would allow:

- A single manager to report say-on-pay votes in cases where multiple managers exercise voting power, indicating on Form N-PX which manager exercises voting power over which security,[16]
- A fund manager to report its say-on-pay votes on behalf of a manager exercising voting power over all or some of a fund's securities[17] and
- Affiliates to file joint reports on Form N-PX as well, notwithstanding that they do not exercise voting power over the same securities.[18]

Potential Impact of the Proposal

Fund Managers' Relationship with Company Management. While say-on-pay votes are advisory and not binding on an issuer, public disclosure could impact fund managers' relationships with company management. For example, company management may seek the support of fund managers ahead of say-on-pay votes.

ESG Strategies. Disclosure of say-on-pay votes will be relevant to many fund managers that market ESG investment strategies. These votes are more likely to be scrutinized by ESG investors, in particular where large, and sometimes controversial, executive compensation packages are at issue. Fund managers committed to ESG investing may need to consider their support of executive compensation packages that fail to hold executives accountable for ESG results and the public perception of that support without the benefit of a full understanding of all the factors that went into a manager's voting decision.

[14] *See id at 88.* The SEC noted that this language "differs somewhat from the current language in Form 13F regarding confidential treatment requests" and that the SEC is "proposing this standard in Form N-PX to conform to a June 2019 U.S. Supreme Court decision that overturned the standard for determining whether information is 'confidential' under Exemption 4 of the FOIA on which the current Form 13F instruction is based."

[15] *See id*. at 89.

[16] *See id*. at 62.

[17] *See id*. at 64.

[18] *See id.*

Prioritizing Voting. In some circumstances the proposed rule may incentivize fund managers to forego revenue from lending in order to demonstrate that shares have been voted. An increase in shares being called back so that fund managers can participate in say-on-pay votes could impact the ability of market participants to sell short by decreasing the supply of shares available to borrow when voting is occurring.

Comment Period

The SEC is soliciting comments on a wide range of items related to the proposed rule and changes to Form N-PX, with all comment letters due within 60 days after the publication in the Federal Register.

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