CARLTON FIELDS

Increased Visibility Into Fund Proxy Voting: SEC Adopts Controversial Requirements

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The SEC has adopted rule and form amendments requiring mutual funds, ETFs, and certain other registered funds (funds) to report more details about their voting of portfolio company proxies.

The requirements, although highly technical, raise substantive issues that caused Republican Commissioners Hester Peirce and Mark Uyeda to dissent. The Investment Company Institute supported many, but not all, of the requirements.

Reports of Fund Voting

Essentially, the SEC amended reporting Form PX to require that funds — including those supporting variable insurance products — 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."

Specifically, the amendments require funds to:

- Identify each voting matter as falling within one of 14 categories 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, 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 the voting record on (or through) their websites and make the record available free of charge upon request.

Institutional Managers' "Say-on-Pay" Disclosures

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.

What is at Stake

The SEC justified the amendments on two policy grounds. First, funds own approximately 32% of the market capitalization of all U.S.-issued equities outstanding and, therefore, "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." Second, more than 45% of U.S. households own funds, and "[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."

Opponents of the amendments countered that: there was scant evidence investors wanted such detailed information; costs would outweigh benefits; and the amendments would enable third parties — whose preferences may differ from the beneficial owners' — to pressure funds to vote in a particular way.

Moreover, regardless of how many potential proxy vote categories Form PX might specify, the types of statistical analyses that the amendments facilitate often will not provide a reasonable understanding of the merits of the proposals faced by a particular fund or the reasoning behind the fund's votes. Accordingly, it seems inevitable that some interest groups will cite such analyses to support conclusions that, although having an air of mathematical precision, are at best questionable. Funds, on the other hand, may struggle to find effective means of communicating a more nuanced view to the broad population of their investors.

Also controversial, is a new requirement that funds disclose the number of securities loaned and not recalled, and thus, not voted. The decision whether or not to recall loaned shares for voting involves weighing the benefits of continuing to earn revenue for shareholders against the value to shareholders of voting on a particular proposal. Opponents fear that failing to recall loaned securities could subject funds, especially ESG funds, to adverse criticism and even discourage funds from realizing revenue from securities lending.

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The new rules and form amendments will be effective for votes occurring on or after July 1, 2023, with the first filings subject to the amendments due in 2024.

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