

Investment Management Regulatory Update - October 2021

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In this issue, we discuss, among other things, recently proposed rule amendments to enhance proxy voting disclosures by investment funds and require disclosure of “say-on-pay” votes by institutional investment managers. Our update also highlights recent statements by SEC Chair Gary Gensler regarding exchange-traded products and regulatory initiatives with respect to industry trends in asset management.

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Rules and regulations

SEC proposes to enhance proxy voting disclosure by investment funds and require disclosure of “say-on-pay” votes for institutional investment managers

The proposed amendments to Form N-PX would enhance the information investment funds report about their proxy votes. The proposed amendments also would require institutional investment managers to disclose how they voted on executive compensation, or so-called “say-on-pay” matters.

On September 29, 2021, the Securities and Exchange Commission (SEC) proposed amendments to Form N-PX to enhance the information mutual funds, exchange-traded funds (ETFs), and other registered management investment companies (collectively, funds) currently report annually about their proxy votes. The SEC also proposed new Rule 14Ad-1 under the Securities Exchange Act of 1934, as amended (Exchange Act) and amendments to Form N-PX to require

institutional investment managers subject to Section 13(f) of the Exchange Act (managers) to report annually on Form N-PX how they voted proxies on executive compensation, or so-called “say-on-pay” matters.

The SEC Commissioners voted 4 to 1 in favor of advancing [the proposal](#), with Commissioner Hester Peirce dissenting.¹ Comments on the proposal must be submitted within 60 days of its publication in the Federal Register.

Say-on-pay vote disclosure for institutional investment managers

Proposed Rule 14Ad-1 under the Exchange Act would require institutional investment managers² subject to Section 13(f) of the Exchange Act³ to report on Form N-PX each say-on-pay vote over which the manager exercised voting power. The proposed rule, if adopted, would complete implementation of Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).⁴

The SEC also proposed the following three amendments to Form N-PX that would permit joint reporting of say-on-pay votes by managers, or by managers and funds, to avoid duplicative reporting:

- An amendment that would permit a single manager to report say-on-pay votes in cases where multiple managers exercise voting power;
- An amendment that would permit a fund to report its say-on-pay votes on behalf of a manager exercising voting power over some or all of the fund’s securities; and
- An amendment that would permit affiliates to file joint reports on Form N-PX notwithstanding that they do not exercise voting power over the same securities.

In all three cases, where another manager or fund reports say-on-pay votes on a manager’s behalf, the report on Form N-PX that includes the manager’s votes would be required to identify the manager on whose behalf the filing is made and separately identify the securities over which the non-reporting manager exercised voting power.

Managers that request confidential treatment of certain or all the positions reported on their Form 13F may request that such information also be treated as confidential on their Form N-PX. The SEC stated, however, that it believes that confidential treatment could be justified only in narrowly tailored circumstances and generally would not be merited solely in order to prevent proxy voting information from being made public.

Form N-PX amendments

The amendments to Form N-PX would:

- Require funds and managers to tie the description of each proxy voting matter to the issuer’s form of proxy and to categorize each matter by type to help investors identify votes of interest and compare voting records;
- Require funds and managers to disclose how their securities lending activity impacted their voting; and
- Prescribe how funds and managers organize their reports and require them to use a structured data language to make the reports easier to analyze.

Each of these proposed amendments is described below.

Identification of proxy voting matters and categories

Currently, funds often use different language to describe a particular proxy proposal and do not categorize their proxy votes by type. The lack of a standardized description for each proposal can make it difficult to compare how funds voted on a particular proposal. To address this, the SEC is proposing to require funds and managers to identify proxy voting matters reported on Form N-PX in the same order and using the same language as on the issuer’s form of proxy.

The SEC is also proposing to require funds and managers to categorize each proxy voting matter reported on Form N-PX so that investors can focus on the topics they find important. The proposed standardized categories and sub-categories include:

- **Board of directors** (subcategories: director election, term limits, committees, size of board, or other board of directors matters (along with a brief description));
- **Section 14A say-on-pay votes** (subcategories: 14A executive compensation, 14A executive compensation vote frequency, or 14A extraordinary transaction executive compensation);

- **Audit-related** (subcategories: auditor ratification, auditor rotation, or other audit-related matters (along with a brief description));
- **Investment company matters** (subcategories: change to investment management agreement, new investment management agreement, assignment of investment management agreement, business development company approval of restricted securities, closed-end investment company issuance of shares below net asset value, business development company asset coverage ratio change, or other investment company matters (along with a brief description));
- **Shareholder rights and defenses** (subcategories: adoption or modification of a shareholder rights plan, control share acquisition provisions, fair price provisions, board classification, cumulative voting, or other shareholder rights and defenses matters (along with a brief description));
- **Extraordinary transactions** (subcategories: merger, asset sale, liquidation, buyout, joint venture, going private, spinoff, delisting, or other extraordinary transaction matters (along with a brief description));
- **Security issuance** (subcategories: equity, debt, convertible, warrants, units, rights, or other security issuance matters (along with a brief description));
- **Capital structure** (subcategories: stock split, reverse stock split, dividend, buyback, tracking stock, adjustment to par value, authorization of additional stock, or other capital structure matters (along with a brief description));
- **Compensation** (subcategories: board compensation, executive compensation (other than Section 14A say-on-pay), board or executive anti-hedging, board or executive anti-pledging, compensation clawback, 10b5-1 plans, or other compensation matters (along with a brief description));
- **Corporate governance** (subcategories: articles of incorporation or bylaws, board committees, codes of ethics, or other corporate governance matters (along with a brief description));
- **Meeting governance** (subcategories: approval to adjourn, acceptance of minutes, or other meeting governance matters (along with a brief description));
- **Environment or climate** (subcategories: greenhouse gas (GHG) emissions, transition planning or reporting, biodiversity or ecosystem risk, chemical footprint, renewable energy or energy efficiency, water issues, waste or pollution, deforestation or land use, say-on-climate, environmental justice, or other environment or climate matters (along with a brief description));
- **Human rights or human capital/workforce** (subcategories: workforce-related mandatory arbitration, supply chain exposure to human rights risks, outsourcing or offshoring, workplace sexual harassment, or other human rights or human capital/workforce matters (along with a brief description));
- **Diversity, equity, and inclusion** (subcategories: board diversity, pay gap, or other diversity, equity, and inclusion matters (along with a brief description));
- **Political activities** (subcategories: lobbying, political contributions, or other political activity matters (along with a brief description));
- **Other social** (subcategories: data privacy, responsible tax policies, charitable contributions, consumer protection, or other social matters (along with a brief description)); and
- **Other** (along with a brief description).

When categorizing a particular voting matter, a fund or manager would be required to select multiple categories or subcategories for the matter, if applicable.

Quantitative disclosures and securities lending

Investors currently do not have transparency into when funds do not cast votes because their securities are out on loan. To address this, the SEC is proposing to require funds and managers to disclose on Form N-PX (1) the number of shares that were voted (or, if not known, the number of shares that were instructed to be cast), (2) how those shares were voted (e.g., for or against proposal, or abstain) and (3) the number of shares that were loaned and not recalled for voting. The SEC noted that, in addition to providing context for understanding how securities lending activities affect fund and manager voting practices, the disclosure would allow an investor to understand the magnitude of split votes (i.e., when a fund or manager votes in multiple ways on the same matter).

Structured data language and standardized reporting format

Reports on Form N-PX are currently required to be filed in HTML or ASCII. The SEC is proposing to require funds and managers to file reports on Form N-PX in an eXtensible Markup Language (XML)-based structured data language, which

would make it easier to analyze the data. The SEC is also proposing to standardize the order of the Form N-PX disclosure requirements and require a fund that offers multiple series of shares to provide Form N-PX disclosure separately by series.

Website availability of fund proxy voting records

The SEC also proposed amendments to Forms N-1A, N-2, and N-3 that would require funds to disclose that their proxy voting records are publicly available on (or through) their websites and available upon request, free of charge in both cases. A fund could make its proxy voting record available through its website by providing a direct link on its website to its Form N-PX report on the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.

Industry update

SEC Chair Gensler statement on complex exchange-traded products

On October 4, 2021, SEC Chair Gary Gensler delivered a statement regarding complex exchange-traded products (ETPs). According to Chair Gensler, this statement is the latest development in a broader effort to take a deep look into the risks of ETPs.

Chair Gensler noted his particular focus on ETPs because they “use strategies and structures that are more complex than typical stocks and bonds.” In his statement, he noted that these complex ETPs have been on the SEC's radar for some time – for example, since 2009, the SEC has warned the public about the risks that complex ETPs can pose to individual investors, and has more recently settled charges against financial professionals who recommended that retail customers buy and hold risky ETPs that were intended for short-term trading strategies. Chair Gensler believes that ETPs are not just risky for retail investors, but also for sophisticated investors, and can even “potentially create system-wide risks by operating in unanticipated ways when markets experience volatility or stress conditions.”

Chair Gensler has requested that SEC staff prepare recommendations for proposed rule-making to address these risks.

– See a copy of the [statement](#)

SEC Chair Gensler remarks before the Future of Asset Management North America Conference

On September 29, 2021, SEC Chair Gary Gensler delivered prepared remarks before the Future of Asset Management North America Conference. Chair Gensler's comments focused on the future of the asset management industry and the host of regulatory initiatives underway at the SEC in response to various industry trends.

Chair Gensler began by revisiting the history of the asset management industry in the United States and highlighting the expansion of the industry in the last century. In particular, Chair Gensler noted the “significant growth in the size and number of private funds, in particular private equity and venture capital funds.” Relatedly, Chair Gensler noted that the industry “not only is growing; it is evolving.” As new industry trends emerge and pose new “risks for markets and investors,” Chair Gensler resolved that “[the] SEC must grow and evolve with the industry.”

Chair Gensler then turned to discussing various regulatory projects underway at the SEC in light of new trends in the asset management field. First, he touched on the importance of fund disclosures, reaffirming his support of efforts that “[enhance] the proxy voting disclosures that registered funds provide to shareholders.”

Next, Chair Gensler noted that the increased use of digital engagement practices (DEPs), such as predictive data analytics, raises questions regarding whether “they are maximizing [the returns of] investors, or [...] the revenues of the platforms.” Relatedly, he suggested that to the extent that such DEPs are “maximizing revenues or doing a bit of both,” regulatory actions by the SEC may be warranted to “address the potential conflicts of interests that arise.”

In his third point, Chair Gensler touched on the regulation of private funds. To that end, he has asked SEC staff for recommendations for “consideration of enhanced reporting and disclosure through Form PF or other reforms.”

Chair Gensler's fourth point emphasized the need to regulate the naming practices of funds that use terms such as “green,” “sustainable,” and “low-carbon.” With respect to these sustainability-oriented naming practices, he has directed SEC staff to “consider recommendations about whether funds should disclose the criteria and underlying data they use to make these claims.”

The fifth item on Chair Gensler's regulatory agenda involved money market funds and open-end funds. He stated that the SEC will "continue to make those funds more resilient, learning from the Covid-related market events of March 2020."

Chair Gensler concluded his remarks by discussing the emergence of investment vehicles providing exposure to crypto assets. He noted that a number of open-end mutual funds and exchange-traded funds have sought to invest in Chicago Mercantile Exchange-traded bitcoin futures. He stated that he looks forward to SEC staff review of these funds' filings under the Investment Company Act to ensure significant investor protections.

– [See Chair Gensler's remarks](#)

¹ In a [statement](#) on the proposal, Commissioner Peirce expressed concern that "while fund shareholders may not be interested in [Form N-PX] information, activists of every stripe can use the fact that funds have to publish their votes to increase their leverage through intimidation and negative publicity." Accordingly, the statement includes a question regarding whether the SEC should eliminate mandatory fund voting disclosures altogether to reduce reporting expenses, allow for presumptive confidentiality of votes, and emphasize that the SEC does not take a position on whether or not funds should vote.

² The term "institutional investment manager" includes 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.

³ Section 13(f) of the Exchange Act requires an institutional investment manager to file a report with the SEC if it exercises investment discretion with respect to accounts holding certain equity securities (Section 13(f) securities) having an aggregate fair market value on the last trading day of any of the preceding 12 months of at least \$100 million. Rule 13f-1 under the Exchange Act requires that institutional investment managers file quarterly reports on Form 13F if the accounts over which they exercise investment discretion hold an aggregate of more than \$100 million in Section 13(f) securities.

⁴ Section 951 of the Dodd-Frank Act added new Section 14A to the Exchange Act. This section generally requires public companies to hold non-binding shareholder advisory votes to: (1) approve the compensation of its named executive officers; (2) determine the frequency of such votes, with the option of every 1, 2, or 3 years; and (3) approve "golden parachute" compensation in connection with a merger or acquisition (collectively, say-on-pay votes). Section 14A(d) of the Exchange Act requires that every manager report at least annually how it voted on say-on-pay votes, unless such vote is otherwise required to be reported publicly. In 2010, the SEC proposed rules to implement Section 14A(d) of the Exchange Act that would have required managers to file their record of say-on-pay votes with the SEC annually on Form N-PX, and would have amended Form N-PX to accommodate the new manager filings. The 2010 proposal was never finalized.