ALERTS

SEC Adopts New Reporting Requirements for Form 13F Filers to Disclose "Say-On-Pay" Votes and Enhances Voting Disclosures Required by Registered Funds

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On Nov. 2, 2022, the Securities and Exchange Commission ("SEC") adopted new Rule 14Ad-1 and amendments to Form N-PX. Under new Rule 14Ad-1, Form 13F filers will be required to disclose their proxy votes on executive compensation matters, otherwise called "say-on-pay" [1] votes, annually on Form N-PX, a reporting form formerly required to be filed exclusively by investment companies registered under the Investment Company Act of 1940, as amended ("1940 Act"). In addition to expanding the scope of Form N-PX to certain private funds and their investment advisers, the changes to Form N-PX will also require more comprehensive information from mutual funds, exchange-traded funds and certain other investment companies registered under the 1940 Act, and will make the information provided by such funds easier to analyze. 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.

The changes were originally proposed in September 2021 and discussed by SRZ attorneys here and here.

> *1. Reporting Obligations Extended to Investment Managers and Funds*: Rule 14Ad-1 under the Exchange Act will now require "institutional investment managers" subject to the reporting requirements of Section 13(f) under the Exchange Act to file their "say-on-pay" votes pursuant to subsections 14A and 14(b) of the

Exchange Act[2] with the SEC annually on Form N-PX by August 31 of each year.[3] This means that not only must registered investment companies file Form N-PX as previously required by Section 30 of the 1940 Act, but that certain private funds and managers must also do the same.[4]

A manager is required to report its "say-on-pay" votes if it "exercised voting power" over a security with respect to such votes. The SEC has adopted a two-part test for determining if a manager exercised voting power over a security. The manager must (1) have the power to vote, or direct the voting of, a security and (2) "exercise" this power to influence a voting decision for the security. This test, according to the SEC's Adopting Release, "focuses on the exercise, rather than the mere possession, of voting power."[5] There will be no reporting requirement where a voting decision is entirely determined by a manager's client or another party.

A manager deciding not to vote or whether to recall loaned securities in advance of a record date for a vote in order to vote the shares is exercising voting power according to the SEC's Adopting Release. For managers that have disclosed to their clients a policy of not voting proxies and who have not voted proxies during the reporting period, the SEC adopted a streamlined reporting option which would indicate this status and not include information on a security-by-security basis as managers reporting votes would be required to do. [6]

2. More Stringent Information Organizing Requirements: With the aim of making the information on Form N-PX "easier to analyze, digest, and access,"[7] changes to Forms N-PX will now:

a. Standardize votes into categories, such as director elections, say-on-pay and audit matters;

b. Require reporting persons to identify proxy voting matters using the same language as disclosed in the issuer's form of proxy, presented in the same order as the matters appear in the form of proxy, and identify directors separately for director election matters, if applicable; and

c. Allow managers to indicate that they have a disclosed policy of not voting proxies and did not vote during the reporting

period.

In addition, Forms N-1A, N-2 and N-3 now require funds to disclose that their proxy voting records are available on (or through) their websites. These changes were instituted, in part, to help investors analyze voting reports, and therefore the new rules require filing using XML language which is a machine readable, or "structured," data language.

3. Disclosure of Securities Lending: In an attempt to provide greater transparency on fund lending practices and how these practices might affect voting practices, Form N-PX filers must also now disclose on Form N-PX the number of shares that were voted or instructed to be voted, as well as the number of shares loaned and not recalled and thus not voted. As stated in the Adopting Release, however, there would not be a disclosure requirement in instances where (a) a manager is not involved in, directly or indirectly, lending shares in a client's account, such as in instances where a broker rehypothecates shares under a margin account, or (b) when a client hires a securities lending agent for securities in the client's account.

Effects of the Rules

As we noted last year, these changes may have the following effects on fund managers:

- Fund managers may now feel obliged to justify their say-on-pay voting positions to investors, activists and company management.
- While the rule does allow for confidential treatment for "say-on-pay" votes, the SEC has cautioned that confidential treatment would only be granted in "narrowly tailored circumstances," such as when a corresponding confidential treatment is granted for Form 13F.
- Funds that are marketed as ESG funds are likely to face additional scrutiny with respect to how they cast these types of votes.
- Funds that do not vote their shares and have no clearly disclosed policy on not voting now must report their abstention from voting.
- Finally, although the SEC argues that the requirement to disclose securities that were loaned and not voted gives investors greater transparency into whether a fund manager has decided to recall a

loaned security to vote or essentially determined not to vote, it is important to note that while the rule provides investors with the end result, the rule does not provide any insight into the manager's process for weighing the relative benefits of voting versus lending[8]. As the SEC notes in the Adopting Release, the new loan disclosure requirements now create incentives for managers to recall loans in prior to a vote to conceal loans (or possibly also short positions), thus potentially impacting securities lending practices.[9]

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

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[1] "Say-on-pay" votes were introduced with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") in 2010 and relate to shareholder votes approving compensation for "named" executive officers, including "golden parachute" compensation arrangements, as well as how frequently shareholders may approve these compensation arrangements. The reporting requirements for Form 13F filers implement requirements added by Dodd-Frank.

[2] This includes "say-on-pay" votes of issuers who have a class of securities registered under Section 12 of the Securities Exchange Act of 1934, as amended, subject to the proxy rules. The new reporting requirement is not however strictly limited to "say-on-pay" votes when voting Section 13(f) securities.

[4] The SEC estimates that approximately 8,147 Form 13F filers will now need to file Form N-PX under the amendments.

[5] "Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers," Exchange Act Release No. 34-96206 (Nov. 2, 2022) (the "Adopting Release") at section II.B.2, available here.

[6] Adopting Release at 22.

[7] Statement of Commissioner Caroline A. Crenshaw; "Statement on Enhanced Reporting of Proxy Votes;" (Nov. 2, 2022) *available at* https://www.sec.gov/news/statement/crenshaw-statement-amendments-form-npx-110222.

[8] The Adopting Release notes however that the form as amended will permit reporting persons to include additional disclosures which could be used to explain the rationale for not recalling loaned securities. Adopting Release at 40-41.

[9] Adopting Release at 112.

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