Public Statement

Shining a Light on Corporate Democracy: Statement on Updates to Form N-PX

Commissioner Allison Herren Lee

Sept. 29, 2021

Corporations are owned by shareholders and shareholders have a voice in how their companies are run. That voice comes through the voting rights attached to their shares. Who handles that voting? Largely, investment companies[1] ("funds") and institutional investment managers[2] ("managers") because most Americans who invest do so through funds and other intermediaries. As a result, funds and managers wield significant influence at the corporate ballot box. Opinions vary widely about whether to vote for or against specific proxy proposals. That's as it should be; that's how corporate democracy works. In fact, it's that divergence of views that makes transparency around how votes are cast all the more important. That is what today's proposal is about.

The Commission proposes today the most meaningful improvements to the disclosure of fund voting information since the requirement to disclose was first adopted nearly 20 years ago.[3] Today's proposal would also implement a long overdue Dodd-Frank mandate for institutional investment managers to disclose their say-on-pay votes by using the same form as funds.[4] I am pleased to support the staff's recommendation today, and I want to thank the teams in both the Division of Investment Management and the Division of Economic and Risk Analysis for their thoughtful work on today's proposal.[5]

The proposal would introduce several important new features to enhance voting disclosure, including requirements for funds and managers to standardize the description of matters voted on, categorize the various types of votes cast, and disclose the required information using structured or electronically "tagged" data for ease of analysis. Each of these proposed new features will bring greater transparency to how intermediaries cast votes on behalf of investors.

I want to briefly highlight two significant aspects of today's proposal. First, the ways in which the proposed disclosure would benefit both investors *and* the public. And second, the importance of structured data in modern markets to achieve true transparency and utility.

Today's proposal requires the disclosure of information that is both in the public interest and for the protection of investors. That is our statutory mandate under both the Investment Company Act and the Securities Exchange Act —the central sources of our authority for this proposal. The Investment Company Act states that we may require disclosure that is "necessary or appropriate in the public interest *or* for the protection of investors."[6] In other words, the statute permits us to serve either goal, and today we serve both. It is critical for investors and the public —academics, policy makers, issuers, and a wide variety of market participants—to understand and evaluate the role of funds and managers in the capital markets. Funds and managers, acting on behalf of their shareholders and clients, have the potential to exercise substantial influence over issuers of all sizes.[7] In fact one recent study

finds that just three large fund complexes cast an average of about 25% of the votes at S&P 500 companies, often with the ability to tip the scales on important matters of corporate governance.[8]

Thus, how voting authority is exercised—or, in some cases, not exercised[9]—is unquestionably significant to the investors who rely on intermediaries to vote their investment dollars. And it is unquestionably significant to the broader public in understanding the influence of these intermediaries on our capital markets. I hope we will hear from a broad swath of the public in the comment process on how best to bring this needed transparency.

In service to transparency, I'm also very pleased to see today's proposal will require voting information to be disclosed in a structured, machine-readable format.[10] There are thousands of funds, thousands of public companies and tens of thousands of ballot issues at these companies each proxy season. Voting data is important not just at the micro level—meaning a specific vote on a specific ballot issue at a specific company–but also at the macro level and in various aggregate forms—meaning whether and how funds, fund complexes, and managers vote broadly when it comes to contested issues or certain kinds of public policy proposals and how that voting compares to the voting of others.[11] Structured data will facilitate both types of analyses, and I look forward to feedback from commenters on whether and how we can further improve the proposal in this respect.

Lastly, let me mention one other area where I encourage public comment and that is whether we have landed in the right place with respect to how often votes must be reported. Today's proposal leaves in place the existing annual filing requirement.[12] In light of the potential for funds and managers to collectively cast deciding votes on important ballot issues, does annual reporting provide investors and the public with sufficiently timely information to effectively monitor voting practices? Have advancements in technology—such as the proliferation of structured data and automated voting and reporting platforms—made it easier to report proxy votes on a more timely or frequent basis, whether on Form N-PX or on their own websites? And if so, how might more frequent reporting assist investors and others throughout the proxy voting season?

I am mindful of the potential risks and burdens associated with more frequent voting disclosures.[13] But, I believe it is important for the Commission to weigh those risks and burdens against the potential benefits to investors and the public. Benefits such as, for example, being able to engage with a fund or manager in the midst of proxy season if or when their voting is misaligned with either disclosed approaches or investor interests.[14] Alternatives to the proposed annual reporting regime could include, for example, more frequent website disclosure in addition to an annual filing of Form N-PX,[15] or quarterly filings of Form N-PX that align with funds' disclosures of their holdings.[16] I encourage investors and the public to help us weigh whether more timely disclosure would be beneficial and, if so, how it should be accomplished.

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With that, I'll say thank you again to the staff for your work on this rule and a special thanks to Sirimal Mukerjee in Chair Gensler's office for working so diligently and collaboratively to address comments and concerns and get this proposal across the finish line. Shareholder voting is at the heart of corporate democracy, and when those votes are cast by intermediaries, transparency is at the heart of our trust in that system. I'm pleased to support this proposal.

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[1] The use of "funds" herein refers to registered management investment companies—such as mutual funds, closed-end funds, and exchange-traded funds—all of which are required by Rule 30b1-4 under the Investment Company Act of 1940 ("Investment Company Act") to file an annual report containing their proxy voting record on Form N-PX. *See* 17 C.F.R. 270.30b1-4.

[2] Section 13 of the Securities Exchange Act of 1934 ("Exchange Act") defines an 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." 15 U.S.C. 78m(f)(6). As used herein, the term "manager" means any institutional investment manager subject to the

reporting requirements of Section 13(f) of the Exchange Act and Rule 13f-1 thereunder. *See* 15 U.S.C. 78(m) and 17 C.F.R. 240.13f-1. Those provisions generally require any institutional investment manager exercising investment discretion over accounts with an aggregate value of at least $100 million to disclose the holdings of such accounts on Form 13F on a quarterly basis. *Id.*

[3] *See* Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, Proposed Rule, Investment Company Act Rel. No. [Forthcoming] (Sept. 29, 2021) ("Proposal"). *See also* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Final Rule, Investment Company Act Rel. No. 25922 (Sept. 23, 2003) (adopting, among other things, new rule 30b1-4 requiring management investment companies to publicly report their proxy voting record on new Form N-PX).

[4] *See* Exchange Act Section 14A(d), 15 U.S.C. 78n-1(d) (requiring that "[e]very institutional investment manager subject to [Exchange Act Section 13(f)] shall report at least annually how it voted" on say-on-pay matters). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, Section 951 (July 21, 2010) (amending the Exchange Act by adding new section 14A (15 U.S.C. 78n-1) relating to shareholder approval of executive compensation). As used herein, "say-on-pay votes" refers to non-binding shareholder advisory votes on executive compensation matters pursuant to Section 14A of the Exchange Act. *See* 15 U.S.C. 78n-1(a) and (b). Such votes generally include three categories of votes required by Section 14A: 1) whether to approve the compensation of certain named executives; 2) the frequency of say-on-pay votes (every one, two, or three years); and 3) whether to approve "golden parachute" compensation in connection with a merger or acquisition.

[5] From the Division of Investment Management, I'd like to thank: Acting Director Sarah ten Siethoff, Tim Dulaney, Brian Johnson, Angela Mokodean, Nathan Schuur, Gregg Jaffray, and Terri Jordan. From the Division of Economic and Risk Analysis: Director Jessica Wachter, Hanna Lee, Marina Martynova, Alex Schiller, PJ Hamidi, and Andrew Glickman.

[6] Section 8 of the Investment Company Act empowers the Commission to require disclosure of such information and documents that the Commission finds is "necessary or appropriate in the public interest or for the protection of investors." 15 U.S.C. 80a-8(a). Similarly, Section 45(a) states that the information contained in filings made with the Commission shall be made public unless the Commission "finds that public disclosure is neither necessary nor appropriate in the public interest or for the protection of investors." 15 U.S.C. 80a-44(a).

As it relates to managers, the legislative history of Exchange Act Section 13(f) reflects Congress' intent that the disclosure requirement benefit the publicly broadly. The Senate Report associated with the relevant legislation flags numerous categories of potential beneficiaries, including: investors, individuals, data aggregators (referred to as "firms with computer processing capabilities"), regulatory agencies, other institutional investment managers, and issuers. *See* Securities Acts Amendments of 1975: Hearings on S. 249 before a Subcomm. of the Senate Comm. on Banking, Housing and Urban Affairs, 94th Cong., 1st Sess. (S. Report No. 94-75) (1975). Moreover, the Senate Report states that the disclosure requirement will "substantially improve the body of factual data about large investment managers which is available to individuals" and that Congress' intent is to permit "careful consideration by interested persons of the public policy implications" and "reasoned discussion and decisions about the influence and impact of the large institutional investment managers on the securities markets." The focus on how disclosure by institutional investment managers could be used to inform public policy discussions is a clear signal that such disclosure was intended to benefit the public at large in considering the influence of institutional investors. In enacting Exchange Act Section 14A, Congress specifically applied the new reporting requirement to those managers subject to Section 13(f) reporting, and by doing so expanded the information available to the public to serve the purposes underlying Section 13(f).

[7] *See* Matt Phillips, Exxon's Board Defeat Signals the Rise of Social-Good Activists, N.Y. Times (June 9, 2021), www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html (discussing how an activist campaign to install three new directors on Exxon's board against the recommendation of management was successful only because of the support of three of the nation's largest fund complexes).

[8] *See* Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. Rev. 721, 724 (2019) (stating that "[f]ollowing two decades of growth, the Big Three now collectively hold an average stake of more than 20% of S&P 500 companies and that "shares held by the Big Three represent an average of about 25% of the shares voted in director elections at S&P 500 companies in 2018"). See also John C. Coates IV, The Future of Corporate Governance Part I: The Problem of Twelve (Harvard John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 1001, 2019), http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_1001.pdf (discussing the increasing concentration of control over public companies by a small number of index fund managers); Matt Levine, Bloomberg Opinion (June 25, 2020), https://www.bloomberg.com/opinion/articles/2020-06-25/the-government-wants-esg-out-of-pensions ("There is another government, in the world, consisting of a handful of gigantic institutional asset managers . . . who own (on behalf of their customers) most of the stocks of most of the public companies, and can, in some loose sense, tell those companies how to behave. They are not chosen democratically, exactly, but they are *representative*; millions of people give their money to those institutions and trust them to make decisions for them.") (emphasis in original).

[9] In addition to the requirement for funds and managers to disclose how they vote on each ballot item, the proposal includes a requirement to disclose the number of shares on loan as of the record date and not recalled. *See* Proposed Item 1(i) of Form N-PX. *See also* Proposed Rule 14Ad-1(d)(1) (defining "voting power" to include, among other things, "the ability to determine whether to vote the security or to recall a loaned security"). The release correctly notes that a decision not to recall shares on loan is, in effect, a voting decision because the fund or manager is unable to use the voting power associated with those shares. *See, e.g.*, Proposal, *supra* note 3, at 51 ("Absent this disclosure [of the number of shares on loan], investors would not have information about a manager's decision not to recall a loaned security, which is similar to the decision not to vote on a matter.").

[10] *See* Proposal, *supra* note 3, at 75-81 (discussing the proposed requirement for filings to be submitted in a custom eXtensible Markup Language ("XML") -based structured data language created specifically for reports on Form N-PX).

[11] *See* Proposal, *supra* note 3, at 77 ("Commenters that expressed support suggested that structured data would: improve investor analysis or allow for more informed decision-making, improve third-party analyses of voting information or reduce the costs associated with preparing them, and generally benefit investors or improve the usefulness and accessibility of reported data."), 79 ("We believe that reporting in custom XML language will allow investors to aggregate and analyze the reported data in a much less labor-intensive manner"), 107 ("We also expect these amendments could facilitate comparisons of voting patterns across a wide range of funds or within an individual fund over time.").

[12] *See id.* at 81-85 (discussing the timing requirements and requesting comment on whether the Commission should adopt a requirement for funds and managers to disclose their voting record more frequently).

[13] At present, funds and managers are required to disclose their holdings on a quarterly basis using Form N-PORT and Form 13F, respectively. If the Commission were to require disclosure of proxy voting information more frequently than quarterly, such disclosure could, in effect, act as holdings disclosure if it predates the filing of a Form N-PORT or Form 13F covering the relevant position(s). As the Commission acknowledges in today's release, a requirement for timelier disclosure could, depending on how it is implemented, contribute to concerns by some about the potential for third-parties to use this information in order to either front-run or reverse engineer a fund's or manager's strategy. *See* Proposal, *supra* note 3, at 125. The Commission could consider, however, whether the existing level of transparency for certain types of funds—such as index funds and the majority of exchange-traded funds—reduces the potential for timelier disclosure to contribute to these concerns. *See id.* at 85, Question 79.

[14] See, e.g., Risk Alert: The Division of Examinations' Review of ESG Investing, Division of Examinations, U.S. Securities and Exchange Commission (Apr. 9, 2021), https://www.sec.gov/files/esg-risk-alert.pdf ("The staff observed inconsistencies between public ESG-related proxy voting claims and internal proxy voting policies and practices. For example, the staff observed public statements that ESG-related proxy proposals would be independently evaluated internally on a case-by-case basis to maximize value, while internal guidelines generally did not provide for such case-by-case analysis."); Gita Rao, Opinion: A Surprise about some ESG Funds—They

Actually Vote Against Environmental and Socially Conscious Resolutions, MarketWatch (Dec. 18, 2020), https://www.marketwatch.com/story/a-surprise-about-some-esg-funds-they-actually-vote-against-environmental-and-socially-conscious-resolutions-11608306020 (discussing the voting patterns of certain ESG funds that, despite having an explicit ESG mandate, have voting records that often contradict their stated objectives); Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, 97 Wash. U.L. Rev. 1007 (2020) (discussing why institutional investors' inaction on proxy issues relating to corporate political spending is contrary to the interests of the majority of investors).

[15] It is possible that such an approach—which would require more frequent reporting only on fund/manager websites and retain only an annual filing of Form N-PX—would minimize the burden associated with such a requirement. In light of the fact that funds and managers will already be required to make and keep records of the relevant information, and to report such information in a structured format on Form N-PX, more frequent disclosure online might entail a relatively small burden compared to frequent filings with the Commission of Form N-PX.

[16] Such an approach should mitigate any potential concerns around front-running or reverse engineering as the required disclosure would occur contemporaneously with disclosure of holdings.