

## PROXY VOTING:

### The State of Play

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Over the past several years, institutional proxy voting has been buffeted by political winds, raising the stakes for investment advisers who provide this critical service. This outline surveys existing legal and regulatory requirements, identifies hot topics, emerging risks and trends, and provides practical compliance tips along the way.

## I. Obligations Under the Investment Advisers Act of 1940

### A. General Fiduciary Duty

A proxy vote is a portfolio asset that must be managed according to the same fiduciary standards that apply to the management of any other portfolio asset.

1. While an adviser cannot disclaim an existing fiduciary duty, the duty arises only where the adviser expressly or implicitly assumes responsibility to vote proxies for, or make voting recommendations to, clients. Even then, the contours of fiduciary duty may be shaped by agreement. For example, the client and adviser may agree that the adviser will vote only on certain matters (e.g., tender offers, contested directorships) or only where the client's shareowning exceeds a stated threshold.

- **Compliance Tip:** If you do not want proxy voting responsibility, say so explicitly in your disclosure brochure and client agreement. Silence could be construed as an implicit assumption of voting authority. (*But see below for special requirements under ERISA.*)
- **Compliance Tip:** Before contractually committing yourself to a variety of voting arrangements, make sure you have an effective way to track and test compliance with those disparate commitments.

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<sup>1</sup> This outline is intended as a general discussion of contemporary compliance issues. It is not an exhaustive treatment of the topics discussed, nor does it provide legal advice regarding fact-specific issues an investment adviser may face. We would be pleased to answer any questions you may have about these matters.

- **Compliance Tip:** An unrestricted assumption of proxy voting authority does not mean that you are obliged to vote on every single ballot issue. If you determine that the costs outweigh the benefits in voting on a particular matter and you document that determination, you can refrain from voting.
2. The fiduciary duty of care obliges an adviser to vote proxies or make proxy vote recommendations in its clients' best interests.
    - a. This means that votes and recommendations must be consistent with clients' particular investment objectives, time horizons, and specific instructions (if any).
    - b. It also means that the adviser must monitor corporate events and take reasonable steps to avoid basing its voting decisions and recommendations on materially inaccurate or incomplete information.
  - **Compliance Tip:** Not all ballot issues require the same level of analysis to satisfy the duty of care. Consider conducting enhanced analysis for extraordinary events such as mergers and acquisitions, dissolutions, conversions or consolidations or for contentious matters, such as contested director elections, shareholder proposals or environmental, social or corporate governance (ESG) issues.
  3. The fiduciary duty of loyalty prohibits the adviser from subordinating clients' interests to its own.
    - An adviser could violate its duty of loyalty by failing to devote adequate resources to proxy voting or advising or by voting or recommending votes in a manner that directly or indirectly advances the adviser's interests, but not those of the clients.

## B. The Proxy Rule

Advisers Act Rule 206(4)-6 augments the fiduciary duties of care and loyalty with three requirements.

1. An adviser who exercises voting authority over client proxies must adopt written policies and procedures reasonably designed to ensure that the proxies are voted in clients' best interests.
  - a. While adopting a single set of proxy voting guidelines is certainly the easiest approach, that approach may not produce votes that serve each client's best interest. Short-term investors and long-term

investors may have different interests, while labor unions, faith-based organizations and the like may have perspectives on ballot issues that are not shared by other types of investors.

b. Advisers must be especially careful not to adopt voting policies that put their own interests above the interests of their clients.

- The SEC took enforcement action against an adviser who voted all its clients' proxies according to a set of specialty policies the adviser adopted to curry favor with one type of investor, without considering whether those policies served the interests of other investors.

- **Compliance Tip:** Determine whether a single set of proxy voting guidelines advances the interests of all clients. If it does not, either adopt separate guidelines for separate categories of clients or at least separate policies for discrete issues where clients' interests are most likely to diverge.
- **Compliance Tip:** If you adopt multiple sets of proxy voting guidelines, consider letting clients select the guidelines you use to vote proxies on their behalf.
- **Compliance Tip:** While you should generally be mindful of the costs of proxy voting, you are not obliged to conduct a cost-benefit analysis for each vote. In deciding whether to vote on a particular issue, keep in mind that abstaining from voting may also entail costs in the long run.
- **Compliance Tip:** Your proxy voting policies and procedures should address your sources of information and the level of analysis you use for various issues.
- **Compliance Tip:** If you engage in securities lending, your proxy voting policies and procedures should establish a process for determining whether to recall and vote loaned shares.
- **Compliance Tip:** Be careful about oversimplification. Undertaking to "always" vote with management or in favor of shareholder proposals may be incompatible with "always" voting in clients' best interests. The safer course is to leave room for circumstances that might dictate a vote in the opposite direction.

- **Compliance Tip:** Make sure your proxy voting policies and procedures address how you handle material conflicts between your interests and those of your clients.
2. The adviser must describe its proxy voting policies and procedures to clients and provide a copy of same upon request.
    - Item 17 of the Form ADV brochure (Part 2A) directs advisers to disclose whether have authority to vote client proxies. If they do, they must briefly describe their voting policies and procedures; explain how they address conflicts of interest that may arise in connection with proxy voting; explain how clients may receive a copy of the proxy voting policies and procedures; and say whether, and if so, how, a client may direct voting in particular circumstances. (See proposed amendment of Item 17 in the ESG discussion below.)
  3. Finally, the adviser must tell clients how they can obtain information about how their individual shares were voted.
    - a. This information is also required by Item 17 of the ADV brochure.
    - b. Note that new “say-on-pay” disclosure requirements are in effect for the 2024 proxy season. (See discussion of Form N-PX reporting below.)

### C. The Compliance Rule

Proxy voting also implicates Advisers Act Rule 206(4)-7. In addition to adopting and implementing policies and procedures reasonably designed to comply with the Proxy Rule, advisers must also periodically test the sufficiency of those policies and procedures and the effectiveness of their implementation. In this regard, every step of the voting process should be examined.

1. In addition to confirming voting authority and the selection of voting guidelines that are in each client’s best interest, advisers should periodically ensure that they have adequately disclosed their proxy voting practices, including, where applicable, the use of proxy advisers and standing voting instructions. (See discussion of proxy advisers below.)
  - **Compliance Tip:** Keep in mind that client interests may change over time. Make sure your voting guidelines keep pace with your clients’ investment objectives, time horizons and voting instructions (if any). Consider periodically asking clients to confirm their consent to, or selection of, voting guidelines.

2. The adviser should confirm that it has not missed votes and that its voting decisions (including any decisions not to vote) align with applicable voting guidelines, unless there has been a documented decision to deviate from those guidelines.

➤ **Compliance Tip:** It is not necessary to review every vote. Examining votes regarding particularly consequential or contentious issues and reviewing a meaningful sample of other votes should suffice.

3. The adviser should confirm its compliance with proxy voting disclosure and reporting requirements.

➤ **Compliance Tip:** In order to harmonize compliance testing with your firm's natural work flow, consider scheduling your proxy voting review at the end of proxy season or after filing your Form N-PX.

#### D. Recordkeeping

Advisers must maintain the following records relating to proxy voting:

1. Proxy voting policies and procedures;
2. All proxy statements regarding client securities;
3. A record of each vote cast on clients' behalf;
4. Any documents the adviser creates that either are material to making a voting decision or that memorialize the basis for that decision;
5. All written client requests for information on how their proxies were voted and all responses to requests for voting information;

➤ **Compliance Tip:** You may rely on the EDGAR system or service providers (such as proxy advisers) for copies of proxy statements and may rely on service providers to make and maintain records of votes cast.

6. Documentation of the annual review of the sufficiency and effectiveness of compliance procedures relating to proxy voting;

7. Where the adviser engages a proxy adviser or other third party to assist in the proxy voting process, as discussed below, the adviser should maintain:

- a. Contracts with proxy advisers and other proxy service providers; and

- b. Documentation of initial due diligence and ongoing monitoring of proxy advisers and other proxy service providers.

## II. Obligations Under the Investment Company Act of 1940

Registered investment companies' proxy voting obligations fall into two categories: adoption and disclosure of policies and procedures and disclosure of voting records.

### A. Policies and Procedures

1. Unless they invest exclusively in non-voting securities, investment companies must describe in their registration statements their voting policies and procedures, including the procedures used when a vote presents a conflict between the interests of the fund's shareholders, on the one hand, and those of the fund's investment adviser, principal underwriter or an affiliated person of the fund, its investment adviser or its principal underwriter, on the other. In the alternative, a fund may simply include a copy of the policies and procedures themselves. Where the fund has delegated voting responsibility to its investment adviser or another third party that uses its own policies and procedures to vote fund securities, the designated party's policies and procedures must be disclosed. [Forms N-1A, N-2, N-3 and N-CSR, 17 CFR 274.11A, 274.11a-1, 274.11b and 274.128, respectively.]

2. Although the content of the required disclosure is not prescribed, the SEC has suggested that funds should disclose both general proxy voting policies and procedures and those that relate to voting on specific types of issues. This could include:

- a. The extent to which the fund delegates its proxy voting decisions to, or relies on the voting recommendations of, a third party;
- b. Policies and procedures regarding issues that may substantially affect shareholder rights and privileges;
- c. Information about the extent to which the fund will support or give weight to the views of a portfolio company's management; and
- d. Information on voting ballot issues regarding corporate governance, changes to capital structure, management compensation, and social and corporate responsibility issues.

### B. Voting Records

1. Company Act Rule 30b1-4 requires funds to file reports each year by August 31<sup>st</sup> detailing their complete proxy voting record for the 12-month

period ending June 30<sup>th</sup> of the reporting year. The reports must be filed on Form N-PX, through the EDGAR system.

2. Form N-PX calls for a range of information for each matter relating to a portfolio security considered at any shareholder meeting held during the reporting period. A substantially expanded version of the Form takes effect on July 1, 2024. (See discussion below.)

### III. Obligations Under ERISA

The Employee Retirement Income Security Act of 1974 (ERISA) imposes additional proxy voting obligations on an adviser who manages a private-sector retirement or employee benefit plan, unless voting authority has been expressly reserved to the plan's named fiduciary or assigned elsewhere. These obligations derive from ERISA's basic fiduciary standards that align, to some extent, with the duties of care and loyalty under the Advisers Act.

#### A. Fiduciary Duty

1. An ERISA fiduciary must discharge its duties solely in the interests of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of plan administration. [Section 404(a)(1)(A) and 403(c).]
  - While the statute does not specify what types of benefits are covered by the "exclusive purpose" standard, the courts and the U.S. Department of Labor (DOL) have confirmed that the benefits must be financial.
2. A fiduciary must also discharge its duties with respect to the plan with the care, skill, prudence and diligence under the prevailing circumstances that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims. [Section 404(a)(1)(B).]

#### B. The Investment Duties Regulation

1. Over the years, the DOL issued various guidance on the exercise of fiduciary duty in the context of proxy voting. While a common thread ran through this guidance, the tone of each piece reflected the prevailing political winds. As a general matter, Republican administrations have been more skeptical of the value of proxy voting and have taken a more restrictive view of the types of factors a fiduciary may properly consider when casting ballots on behalf of a covered plan. This is especially so when it comes to consideration of ESG factors that are not exclusively financial or economic. By contrast, Democratic administrations have been more favorably inclined toward the exercise of shareholder rights and have taken a broader view of

the factors a fiduciary may consider in formulating its voting decisions and recommendations.

2. In 2020, the DOL amended ERISA's Investment Duties Regulation (Rule 404a-1) to address proxy voting and ESG investing. Among other things, this amendment obliged advisers to vote proxies solely in plans' economic interests, limited the consideration of non-pecuniary factors and imposed new recordkeeping and monitoring requirements. The amendment also created two safe harbors whose practical effect would limit proxy voting by ERISA plans.<sup>2</sup> In addition, the preamble to the 2020 amendment included statements suggesting that even ordinary exercises of shareholder rights might require special justification.

3. In 2022, the DOL unwound the most chilling aspects of the 2020 changes and adopted a more measured approach to proxy voting. As it stands today, Rule 404a-1 restates basic fiduciary principles, imposes specific requirements for meeting those principles, addresses the use of proxy voting policies and confirms the parameters of voting responsibility, scope of coverage and special treatment of pooled investment vehicles.

#### *A. Fundamental Principles*

i. The fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those shares, including the right to vote proxies. [Rule 404a-1(d)(1).]

ii. When deciding if and how to exercise shareholder rights, a fiduciary must act prudently and solely in the interests of participants and beneficiaries and for the exclusive purpose of providing benefits and defraying reasonable expenses. [Rule 404a-1(d)(2)(i).]

#### *b. Specific Requirements*

When deciding whether to exercise shareholder rights and when exercising those rights, a plan fiduciary must:

i. Act solely in accordance with the economic interest of the plan, its participants and its beneficiaries, in a manner

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<sup>2</sup> The first safe harbor allowed a fiduciary to limit proxy voting to ballot proposals determined to be substantially related to the issuer's business or expected to have a material effect on the value of the plan's investment. The second allowed a fiduciary to refrain from voting whenever the plan's holdings in a subject company relative to the plan's total investment assets are below a certain threshold.



consistent with subsection (b)(4) of the rule [Rule 404a-1(d)(2)(ii)(A)];

- Under subsection (b)(4), the fiduciary must base its determination regarding an investment or investment course of action on factors the fiduciary reasonably determines are relevant to a risk-return analysis, using appropriate investment horizons consistent with the plan's investment objectives, and considering the plan's funding policy. The relevance of any risk-return factor depends on facts and circumstances and may include the economic effects of climate change and other ESG factors. The weight given to any particular factor depends on the fiduciary's assessment of its impact on risk and return.

ii. Consider any costs involved [Rule 404a-1(d)(2)(ii)(B)];

iii. Not subordinate the interests of plan participants and beneficiaries in their retirement income or financial benefits under the plan to any other objective [Rule 404a-1(d)(2)(ii)(I)]; and

iv. Evaluate relevant facts that form the basis for any particular proxy vote or other exercise of shareholder rights [Rule 404a-1(d)(2)(ii)(D)].

See below for requirements regarding the use of proxy advisers and other service providers.

#### *c. Proxy Voting Policies*

In deciding whether to vote proxies on behalf of an ERISA plan, a fiduciary may act in accordance with proxy voting policies that establish specific parameters “prudently designed to serve the plan’s [economic] interests” and that are reviewed periodically. The fiduciary may act in a manner contrary to proxy voting policies if it determines that it is prudent to do so after assessing the likelihood that the matter being voted on will have a material effect on the value of the investment or the investment performance of the plan’s portfolio, and after accounting for the costs involved in voting. [Rule 404a-1(d)(3).]

#### *d. Voting Responsibility*

The plan trustee is responsible for exercising shareholder rights on behalf of the plan except to the extent that either:

- i. The trustee is subject to the direction of a named fiduciary pursuant to § 403(a)(1) of ERISA, or
  - ii. The power to manage, acquire or dispose of plan assets has been delegated to one or more investment managers. [Rule 404a-1(d)(4)(i)(A).] In this case, the manager has the exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets, except to the extent that the plan, trust document or investment management agreement expressly provides that such authority has been reserved to the responsible named fiduciary or assigned elsewhere. [Rule 404a-1(d)(4)(i)(B).]
- **Compliance Tip:** Do not attempt to disclaim responsibility for voting ERISA client proxies without documenting that this responsibility has been properly delegated to someone else.

*e. Scope*

The proxy voting provisions of the Investment Duties Regulation do not apply to voting, tender and similar rights with respect to securities that are passed through to participants and beneficiaries whose accounts hold such securities, pursuant to the terms of an individual account plan. [Rule 404a-1(d)(5).]

*f. Pooled Investment Vehicles*

The manager of a pooled investment vehicle in which multiple plans invest must, “insofar as possible,” reconcile the conflicting investment policies of participating plans, and, if possible, must vote proxies in proportion to the plans’ respective economic interests in the vehicle. In the alternative, the pooled vehicle may adopt a voting policy of its own and require plans to accede to that policy as a condition of investing in the fund. In that case, the fiduciary of each plan must determine that the pooled vehicle’s policy is consistent with Title I of ERISA and the Investment Duties Regulation before deciding to participate in the fund. [Rule 404a-1(d)(4)(ii).]

- **Compliance Tip:** If you want to avoid the onerous process of proportionate voting for a pooled investment vehicle, be sure to adequately disclose your proxy voting guidelines to ERISA plan investors and obtain their consent to those guidelines as a condition of investment.

#### IV. The Use of Proxy Advisers and Other Proxy Service Providers

Proxy voting is a resource-intensive activity. One way to make the process more manageable is to engage the assistance of a proxy adviser or other service provider. Outsourced services can assist with the administrative side of proxy voting, including gathering proxy statements, tracking shareholder meetings and ballot issues, and assisting with the mechanics of voting and reporting. Some proxy advisers function as discretionary vote managers, while others provide research, analysis and voting recommendations based either on the proxy adviser's benchmark or specialty voting guidelines (e.g., labor, climate or faith-based policies) or on the investment manager's own custom voting guidelines. While proxy advisers and other service providers can assist investment managers in meeting their proxy voting obligations, the use of such services has compliance implications.

A. An adviser is not relieved of its fiduciary duties simply because it hires another party to perform an advisory function. In the proxy voting context, this means that an adviser cannot outsource its fiduciary voting obligations to a proxy adviser or other service provider. In fact, the engagement of a proxy adviser or other service provider is itself a fiduciary act requiring the exercise of care and loyalty.

B. Before contracting with a proxy adviser or administrative proxy service, an investment adviser must conduct sufficient due diligence to determine that the proposed engagement is in the best interests of the manager's clients. Due diligence should include a reasonable inquiry into:

1. The adequacy and quality of the service provider's staffing and technology;
2. The service provider's cybersecurity hygiene;
3. The manner in which the proxy adviser formulates its proxy voting guidelines, the sources of information it uses, its engagement with issuers and third parties and its data integrity, quality control and error correction practices;
4. The proxy adviser's mechanisms for alerting clients about changes in vote recommendations based on the receipt of additional information, including information from issuers and shareholder proponents;
5. The independence of the proxy adviser's vote recommendations, which requires an understanding of the proxy adviser's business and the nature of conflicts of interest that business presents;

6. The sufficiency of the proxy adviser's conflict of interest policies and procedures;

7. The sufficiency of the proxy adviser's disclosure practices regarding its relationships with issuers, shareholder proponents and other parties with an interest in the subject proxy votes, and the ease of accessing such disclosure; and

8. Proxy advisers' and administrative voting services' treatment of material non-public information about clients' portfolio holdings and how the investment manager intends to vote client proxies.

C. The proxy service engagement process should include an exit strategy. This includes ensuring that upon termination of a service contract, sensitive client and adviser data will be appropriately safeguarded or destroyed. It also includes ensuring continued access to required books and records maintained by the terminated service provider.

D. Once outsourced proxy voting assistance is procured, the adviser must continue to monitor the service provider's integrity and competence, which might change over time. Ongoing monitoring might include:

1. Receiving periodic certifications of the service provider's compliance with its internal policies and procedures, including policies and procedures regarding conflicts of interest;

2. Receiving notification of material changes to information previously supplied; and/or

3. Periodic meetings with key personnel.

E. The adviser must also monitor a proxy adviser's vote recommendations to reasonably ensure that they are in clients' best interests. The adviser does not have to flyspeck every bit of advice it receives, but it cannot disengage from the voting process and blindly follow the proxy adviser's recommendations.

➤ **Compliance Tip:** If you use standing voting instructions on a proxy adviser's automated voting platform, protect yourself against charges of "robo-voting"<sup>3</sup> by:

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<sup>3</sup> "Robo-voting" is a pejorative term used by some issuers, their spokesfolks and politicians of a certain persuasion to describe a situation in which an institutional investor blindly follows a proxy adviser's vote recommendations.

- Reviewing a sample of pre-populated votes on routine ballot issues to confirm the votes align with the applicable voting guidelines; and
- Conducting a more thorough analysis of the proxy adviser's vote recommendations regarding novel or highly contentious issues to confirm that the recommendations align with clients' best interests.

Depending on what you find, consider whether you should override the proxy adviser's vote recommendation.

- **Compliance Tip:** If, after you cast a vote, you become aware of additional material information about a ballot issue, consider whether you should change your vote, if possible.
- **Compliance Tip:** If you select a proxy adviser's benchmark or specialty voting policies, be sure to stay on top of changes to those policies to ensure that they continue to serve the best interests of your clients.

F. The ERISA Investment Duties Regulation also addresses the use of outsourced proxy voting services.

1. An ERISA fiduciary must exercise prudence and diligence in the selection and monitoring of persons, if any, selected to advise or otherwise assist with exercises of shareholder rights. This includes research providers, proxy advisers and those who provide administrative, recordkeeping or reporting services. [Rule 404a-1(d)(2)(ii)(E).]
2. A fiduciary may not adopt a practice of following the recommendations of a proxy adviser or other service provider without determining that the voting guidelines of such party are consistent with the fiduciary's obligations described in Rule 404a-1(d)(2)(ii)(A) through (E). [Rule 404a-1(d)(2)(iii).]

## V. Hot Topics, Emerging Risks and Trends

### A. Form N-PX Reporting

Beginning in 2024, institutional investment managers who are required to file reports under Securities and Exchange Act of 1934 (Exchange Act) Rule 13f-1 must annually report their precatory say-on-pay proxy votes using the same Form

N-PX that registered investment companies use to report their entire voting records.<sup>4</sup>

### *1. New Requirement for Investment Managers*

Exchange Act Rule 14Ad-1 requires an institutional investment manager to report information about the following types of votes for each security as to which the manager exercised voting power:

- a. Votes to approve the compensation of named executive officers;
- b. Votes to determine the frequency of such votes (*i.e.*, every 1, 2 or 3 years); and
- c. Votes to approve executive compensation in extraordinary transactions (*i.e.*, “golden parachute” compensation in connection with mergers or acquisitions).

### *2. Terminology*

a. An “institutional investment manager” includes an investment adviser who invests in securities on its clients’ behalf. [Exchange Act § 13(f)(6)(A).]

- Note that off-shore 13F filers are also subject to the new N-PX requirements.

b. “Voting power” means “the ability, through any contract, arrangement, understanding, or relationship, to vote a security or direct the voting of a security, including the ability to determine whether to vote a security or to recall a loaned security.” [Rule 14Ad-1(d)(1).]

c. The “exercise” of voting power means the use of voting power “to influence a voting decision with respect to a security.” [Rule 14Ad-1(d)(2).] An investment manager may exercise voting power by voting or by influencing a vote using its own independent judgment.

- Although common sense would dictate that advisers who expressly disclaim voting authority in their advisory agreements or Form ADV should not be subject to the N-PX filing requirement, the SEC rejected the common-sense approach. Investment managers who have no authority to

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<sup>4</sup> Section 951 of the Dodd-Frank Act added a new Section 14A to the Exchange Act to require public companies to hold non-binding shareholder advisory votes relating to certain executive compensation issues. Section 14A(d) requires public reporting of such votes. As noted above, fund reporting obligations derive from Company Act Rule 30b1-4.

vote client proxies, and, in fact, do not vote, are nevertheless obliged to file an annual Form N-PX “Notice Report” to confirm they have nothing to report. A Notice Report is also filed where the manager has, but did not exercise, voting authority for any say-on-pay ballot issue during the reporting period.

- **Compliance Tip:** Determining whether an investment manager “exercises” proxy voting authority is not an intuitive process. For example, a manager who votes in accordance with its own voting guidelines is deemed to exercise voting power, even where the client has selected those guidelines, while a manager who votes according to a client’s say-on-pay guidelines is not, unless the manager exercises its own judgment in applying the client’s guidelines. The proposing release regarding the new N-PX requirements offers examples of what the SEC deems to be the exercise of voting authority. [Exchange Act Rel. No. 93169, Company Act Rel. No. 34389 (Sep. 29, 2021) at 21-25.] Do your best, and at least make sure you take a consistent approach in what you report.

### *3. Joint Reporting*

In light of the broad interpretation of “exercising” voting power, more than one investment manager will sometimes have reporting obligations for the same vote. In such cases, the managers may jointly report the subject votes, with one manager filing a “Voting Report” on Form N-PX that contains the required vote information and the other manager(s) filing a “Notice” Report” on Form N-PX omitting that information. An institutional manager who reports some of its own votes and relies on other manager(s) or fund(s) to report other votes would file a “Combination Report” on Form N-PX.

- a. Where two or more managers jointly report say-on-pay votes for the same securities, the manager that files the N-PX Voting Report must identify the other manager(s) on whose behalf the filing is made. Each non-reporting manager must file an N-PX Notice Report identifying each manager reporting on its behalf.
- b. A manager is not required to report proxy votes that are reported on a Form N-PX filed by a registered investment company. The fund must identify each manager on whose behalf it is reporting votes and each manager must file a Notice Report identifying the fund that is reporting the manager’s votes.

- c. Affiliated institutional investment managers may jointly file a single Form N-PX even if the managers do not exercise voting power over the same securities.
- d. The number of shares being reported on behalf of another manager must be reported separately from the number of shares the reporting manager reports on its own behalf. Furthermore, where the reporting manager reports for different groups of managers, each group's shares must be reported separately. Likewise, a fund must separately report shares that are reported on behalf of different managers or groups of managers. If the fund offers multiple series, it must report each one's voting record separately.
- e. Note that while joint reporting by institutional investment managers is *permitted*, it is not *required*. Where multiple managers exercise voting authority over the same securities, each manager may file its own N-PX Voting Report with the required information. In that case, there is no need to cross-reference the other managers who report the same votes.

#### 4. *Scope and Content*

- a. Although the say-on-pay reporting requirement applies only to managers subject to Section 13(f) of the Exchange Act, the Commission declined to harmonize the scope of the N-PX and 13F reporting requirements. For example, the N-PX requirements are not limited to the kinds of securities managers report on 13F; N-PX does not include 13F's *de minimis* exemption for securities holdings of fewer than 10,000 shares and less than \$200,000 aggregate fair market value; and a manager may be required to report votes on Form N-PX for securities it omits from Form 13F because it does not have investment discretion over them.
- b. Form N-PX consists of a Cover Page, a Summary Page, a Proxy Voting Record and a signature block.
  - i. The Cover Page identifies the institutional investment manager or fund filing the Form N-PX and type of report being filed (Voting, Notice or Combination); indicates whether an investment manager requests confidential treatment regarding one or more votes that are omitted from the report (see discussion below); and, if applicable, identifies other persons reporting for the filing manager.
  - ii. The Summary Page identifies the institutional managers whose votes are being included on this filing (other than the



filing manager or fund), if any. For reports filed by a fund, the Summary Page also includes information about individual series of that fund, if any.

iii. For investment managers, the Proxy Voting Record lists the information that must be disclosed for each shareholder vote over which the manager exercised voting power during the reporting period. For funds, it itemizes the information required for each matter relating to a portfolio security considered at any shareholder meeting held during the reporting period for which the fund was entitled to vote. In addition to identifying the security and shareholder meeting in question, the reporting manager or fund must identify and categorize the matter being voted on. Form N-PX includes a list of ballot categories to choose from. For institutional managers, the relevant category is "Section 14A say-on-pay votes." Fund reporting covers a much broader range of topics, including: director elections, say-on-pay matters, audit-related issues, investment company matters, shareholder rights and defenses, extraordinary transactions, capital structure, compensation issues other than say-on-pay, corporate governance, environment or climate, human rights or human capital/workforce, diversity, equity and inclusion (DEI), other social issues and other matters.

- **Compliance Tip:** In identifying the matters voted on, you must use the same language, in the same order, as that found on the issuer's proxy card. If there is no proxy card (e.g., the vote is not subject to U.S. proxy rules), you must briefly identify the matter voted on, taking care not to use unfamiliar abbreviations.

iv. In addition to the foregoing, the voting record must include the following information:

(a) For fund reports, whether the ballot item was proposed by the issuer or a security holder:

(b) The number of shares voted;

- **Compliance Tip:** You may use the number of voted shares reflected in your records at the time of filing. If you have not received confirmation of actual votes cast by the time you file, you may report the number of

shares you instructed to be cast. Indicate “0,” if no shares were voted.

(c) The number of shares that the reporting person loaned (directly or indirectly through a voting agent) and did not recall;

(d) How the shares were voted (for, against, withhold, or abstain), and if votes were cast in multiple directions, the number of shares voted each way;

(e) Whether the disclosed votes represented votes for or against management’s recommendation;

➤ **Compliance Tip:** If there was no management recommendation, state “None” for this item.

(f) If applicable, the identity of each institutional manager on whose behalf the voting report is being filed (other than the person filing this report);

(g) If applicable, the fund series that was eligible to vote the security; and

(h) Any other information the reporting person would like to provide about the matter or how it voted, provided that such other information does not impede the understanding or presentation of the required information.

## *5. The Mechanics of Reporting*

Form N-PX reports must be filed electronically through the EDGAR system, no later than August 31<sup>st</sup> of each year for the most recent 12-month period ending on June 30,<sup>th</sup> except as discussed in the Transition Rules section below.

➤ **Compliance Tip:** The initial reports on the new version of Form N-PX are due by August 31, 2024, covering the period of July 1, 2023 to June 30, 2024.

## *6. Requesting Confidential Treatment*

Investment managers may request confidential treatment of their proxy voting information in the same manner and subject to the same standards that apply to confidential treatment requests under Exchange Act § 13(f), and consistent with Exchange Act Rule 24b-2. Requests for confidential treatment must be filed electronically, through EDGAR.

1. Confidential treatment may be justified to protect information that is the subject of a pending or granted 13F confidential treatment request. Confidentiality would not be justified, however, simply because the manager has a nondisclosure agreement with a client regarding portfolio information. An investment manager requesting confidential treatment must provide enough factual support for its request to enable the SEC to make an informed judgment as to the request's merits. [Form N-PX, Instructions for Confidential Treatment Requests, Instruction 5.]

2. Confidential treatment of proxy voting information may not extend beyond one (1) year from the date that the Form N-PX report is required to be filed. Except in extraordinary circumstances, within six (6) business days of the expiration of the period for which the SEC has granted confidential treatment (or of the notification of the SEC's denial of a confidentiality request), the manager must file an N-PX amendment reporting the subject information, with a mandatory legend identifying the reason for the filing. [*Id.*, Instructions 6 - 8.]

## *7. Transition Rules*

- a. A Form N-PX need not be filed for the 12-month period ending June 30<sup>th</sup> of the calendar year in which the manager's initial Form 13F filing is due.
- b. Nor must an N-PX be filed with respect to any shareholder vote at a meeting that occurs after September 30<sup>th</sup> of the calendar year in which the manager's final Form 13F filing is due. In that case, the manager must file an N-PX for the stub period of July 1<sup>st</sup> – September 30<sup>th</sup> by March 1<sup>st</sup> of the following calendar year.

## B. The Outsourcing Rule Proposal

Proposed Advisers Act Rule 206(4)-11 would impose a series of prescriptive requirements on an adviser's selection and monitoring of both affiliated and unaffiliated service providers, including proxy voting services. The proposal would also impose extensive new recordkeeping and disclosure requirements on advisers relating to outsourcing. Among other things, an adviser would be obliged to obtain each service provider's reasonable assurance that it can and will coordinate with the adviser for purposes of the adviser's legal and regulatory compliance. Moreover, service providers who create and/or maintain books and records for an investment adviser would be obliged to do so in a manner that satisfies the Advisers Act recordkeeping rule.

## C. ESG

ESG has become the blue touch paper of investment management and, by extension, of proxy voting. Although there is no universally accepted definition of the term, there

are plenty of strong and divergent opinions on the proper role of environmental, social or corporate governance factors in fiduciary investment management. The best way for an investment adviser to keep from getting scorched is to thoughtfully design and implement an approach to ESG, clearly disclose that approach to clients, and keep good records.

### *1. The Federal Regulatory Approach*

For the moment, the SEC and the DOL are taking an even-handed approach to ESG, recognizing that such factors may have economic consequences or may otherwise be considered in a manner consistent with the fiduciary duties of care, loyalty and prudence.

a. In 2022, the SEC proposed new disclosure requirements for investment advisers and registered investment companies relating to their ESG investment practices. In light of increased investor demand for ESG investment strategies, the proposed requirements are “designed to create a consistent, comparable, and decision-useful regulatory framework for ESG advisory services.” [Advisers Act Rel. No. 6034 (May 25, 2022).] As it relates to proxy voting, the proposal:

i. Would amend Item 17.A of the Form ADV disclosure brochure to require advisers that have specific voting policies or procedures that include one or more ESG considerations when voting client securities to include a description of which ESG factors they consider and how they consider them. Where the adviser maintains different ESG-relevant proxy policies for different strategies or clients, those differences would have to be described. Advisers also would have to disclose whether they allow clients to direct their own votes on ESG-related voting matters.

ii. Would amend Forms N-1A and N-2 to require layered disclosure of a registered investment company’s practices regarding the incorporation of ESG considerations in proxy voting and other shareholder engagement. [Proposed Item 4(a)(2)(ii)(B), Instruction 4 of Form N-1A and Proposed Item 8.e.(2)(B), Instruction 4 of Form N-2.]

b. As noted above, Form N-PX now requires investment companies to make granular disclosure of proxy votes on ESG ballot items relating to the environment or climate, human rights, DEI and other social and governance issues.

c. With the repeal of the Trump-era version of the ERISA Investment Duties Regulation, the DOL has also adopted a neutral stance on ESG.

As discussed above, an ERISA fiduciary must base its proxy vote determinations on factors the fiduciary reasonably determines are relevant to a risk-return analysis, which may include the economic effects of climate change and other ESG factors. [Rule 404a-1(d)(2)(ii)(A).]

## 2. *State Initiatives*

State approaches to the ESG implications of proxy voting can be classified as red or blue.

a. *State Retirement Plans and Other Public Funds.* Some states forbid the consideration of ESG factors in the investment process for public funds, while other states require or permit the consideration of such factors if they are material. Some states prohibit investment in, or require divestment from, fossil fuel companies or weapons manufacturers, while other states prohibit such practices or even boycott financial services firms that adopt disfavored practices on hot-button issues like climate or gun control. These restrictions and mandates can be baked into law or made part of the state's investment or proxy voting policy statement or custom voting guidelines.

b. *All Investors.* Some red states have turned to antitrust or blue sky laws to attack ESG practices more broadly. For example, Missouri has adopted a blue-sky rule requiring state registered advisers and state-registered investment adviser representatives (IA Reps) of federally registered advisers to make disclosure to clients and receive written consent prior to incorporating ESG factors into investment decisions. This rule is being challenged in court, but is effective while the litigation proceeds.

c. *Additional Tactics.* In addition to laws, rules and investment or voting policy statements, some states are using investigations, subpoenas, letters from groups of like-minded attorneys general and similar tactics to discourage ESG investing or intimidate financial service providers who are perceived to be “woke.”

## 3. *Congressional Initiatives*

Congressional Republicans have launched a number of missiles at ESG. These include bills to amend the Advisers Act and ERISA to restrict the use of non-pecuniary factors in investment decision-making; the House Financial Services Committee's formation of a Republican ESG Working Group; and an investigation by the House Judiciary Committee into the antitrust implications of allegedly collusive agreements to “promote ESG goals.” Given the

unbridgeable political divide on the Hill, none of these efforts has been productive, but the ongoing threat to advisers cannot be ignored.

#### *4. International Initiatives*

The attitude toward ESG outside the United States is dramatically different than it is here. In Europe and elsewhere, investment managers are encouraged or required to incorporate ESG considerations into their investment practices. Advisers serving non-U.S. clients may be directed to comply with the United Nations Principles for Responsible Investment (U.N. PRI), national stewardship codes or other investment or proxy voting standards that are anathema to some politicians and regulators in the U.S.

- **Compliance Tip:** Regardless of your views on ESG, you must be mindful of the risks these considerations pose to your business. One way to manage risk is to document a reasoned process for determining if and when ESG factors have an economic consequence and if and when they may otherwise be relevant to an investment decision, including a decision regarding proxy votes. Effectively disclose this process to clients and consider obtaining client consent in the investment management agreement or otherwise.
- **Compliance Tip:** Be vigilant with public employee retirement plans or other public funds. If such clients do not supply custom voting policies, make sure you understand all constraints and mandates the applicable state may have imposed on the consideration of ESG factors. These requirements are moving targets, so make sure you stay on top of legislative and regulatory developments.
- **Compliance Tip:** Don't forget that NSMIA (the National Securities Markets Improvement Act of 1996) prohibits states from imposing substantive securities law regulation on federally registered investment advisers and their supervised persons. This means that the states are forbidden to regulate federal advisers' and their IA Reps' consideration of ESG factors in voting client proxies. As noted above, one state's attempt to exercise jurisdiction it does not have is currently being litigated.
- **Compliance Tip:** Wildly divergent attitudes toward ESG may make it challenging to use only one set of proxy voting guidelines for all clients. Consider selecting different policies to meet different client needs, or, if you use a single set of guidelines,

consider making room for different approaches to ballot items that include ESG considerations. You might also consider giving clients the right to direct their votes on ESG matters or to vote these matters themselves.

- **Compliance Tip:** If you use the services of a proxy adviser, make sure you select voting guidelines that align with each client's interests. If you use standing instructions on an electronic proxy voting platform, consider either reserving the right to manually vote ESG ballot items or at least review the vote recommendations for those items before the votes are cast.
- **Compliance Tip:** Pay special attention to ESG issues when conducting your compliance reviews of proxy voting. Among other things, make sure you have complied with client's specific voting instructions and otherwise have satisfied whatever obligations you have assumed regarding votes that entail ESG considerations.
- **Compliance Tip:** Accept the fact that it may not be possible to keep everyone happy. Complying with one state's divestment mandates may violate another state's anti-boycott mandates. As unpalatable as it may seem, sometimes the wiser course is to stay out of the political cross-fire and turn risky business away.

#### D. Pass-Through Voting

Pass-through voting is a mechanism by which investors in a mutual fund or other pooled investment vehicle are given in say in how the proxies of the pooled funds' portfolio securities are voted.

1. As noted above, registered investment companies disclose their proxy voting policies and procedures in their registration statements and file annual reports of their voting records so investors can consider this information in making investment decisions. Under ERISA, managers of pooled investment vehicles that hold assets of more than one employee benefit plan must, to the extent permitted by law, vote proxies in proportion to the participating plans' respective economic interests in the vehicle, unless accession to the pooled vehicle's own proxy policies is made a condition to investment. Pass-through voting is a way to give investors more direct control over the proxy voting decisions made on their behalf.
2. Clients with separately managed accounts (SMAs) already have pass-through voting rights. Because they own the securities in their accounts, they also own the right to vote proxies for those securities. They can

exercise this right either by opting to vote their own proxies, by selecting the proxy voting guidelines their adviser uses, or by directing votes on particular types of issues, if their adviser permits. That said, the technology being developed to enable pass-through voting for collective vehicles may make it easier to give SMA clients a greater say in how their votes are cast without making them assume responsibility for their proxy voting altogether.

3. Pass-through voting comes in many flavors. In some cases, it is limited to institutional investors, while in other cases it is made available to retail investors as well. It is typically used for index funds or other passive investment vehicles but can also be used for other types of collective vehicles. It can afford investors the right to dictate votes on a pro-rata ownership basis, or can be a “softer” process, in which the manager surveys investors to get a sense of their preferences on a range of core proxy issues but continues to exert ultimate decision-making authority over the vote. Where investors dictate proxy votes for a proportionate share of the collective vehicle, they may use their own voting guidelines or may direct the use of a proxy adviser’s benchmark or specialty voting policies or their manager’s custom voting policies.

4. Proponents of the practice fall at both ends of the political spectrum, although the reasons for their support are certainly not aligned. The perceived benefits of pass-through voting (depending on one’s perspective) include:

- a. Democratization of shareholder voting by allowing asset managers’ votes to more accurately reflect their clients’ views;
- b. Improved transparency in fund corporate governance;
- c. Reducing the hegemony of the largest institutional investment managers and the influence of proxy advisers and their perceived liberal biases;
- d. Minimizing the influence of ESG factors on voting decisions; and
- e. Facilitating “values” voting, including the promotion of ESG principles.

5. Of course, not everyone is a fan of this practice. The perceived drawbacks of pass-through voting include:

- a. High implementation costs that exceed likely benefits;
  - Skeptics note that, left to their own devices, few retail investors vote their proxies or demonstrate any interest in doing so. Indeed, many individual investors buy mutual



funds and ETFs precisely because they do not want to be bothered with the details of managing their assets.

- Ironically, the individual investors who are most likely to avail themselves of pass-through voting are the ones who care most about sustainability, climate and DEI.

b. A more difficult and costly investor relations process;

- If a large number of investors want a say in how their proxies are voted, issuers may have to undertake more individual shareholder engagements.

c. Increased influence of proxy advisers; and

- In order to make pass-through voting operationally feasible, many pass-through investors will use standing voting instructions based on proxy advisers' benchmark or specialty policies.

d. Risk of missed votes or inability to get a quorum for shareholder meetings.

- Proxy voting is already a race against the clock due to the compressed nature of proxy season. Adding more steps to the process will make it harder for the adviser to meet voting deadlines.

6. The future of pass-through voting is difficult to predict. Today, it is more popular in Europe than in the U.S., but that could change if the pilot programs by the largest asset managers prove popular and if advances in technology reduce the cost and operational burdens of the process. Or, the politicians could intervene. In 2022, Senate Republicans introduced a bill (S. 4241, the "INDEX Act,") to amend the Advisers Act to require advisers of passively managed funds and SMAs to arrange for pass-through voting under certain circumstances. The bill went nowhere, but it could be resurrected and take flight, depending on which way the political winds blow.

- **Compliance Tip:** Given the political climate, it may be wise to solicit some form of client input regarding proxy voting, even if you do not want to shoulder the burdens of full pass-through voting. Consider adding an acknowledgement or direction of the applicable proxy voting guidelines to your advisory agreement, or

some questions about voting preferences (at least with regard to ESG) to the client's investment policy statement.

- **Compliance Tip:** Certain proxy advisers are offering pass-through voting assistance to institutional clients. If you want to provide this option to your clients without assuming all the attendant operational burdens, you may be able to outsource at least part of the process.

### E. Votes for Sale

Another idea that promises to disrupt traditional notions of proxy voting is to allow investors to sell their proxy voting rights, while retaining ownership of the securities generating those rights. At least one company has created a marketplace for this purpose. [Alexander Osipovich, *Votes for Sale! A Startup is Letting Shareholders Sell Their Proxies*, WALL ST. J. (Jan. 21, 2024), <https://www.wsj.com/finance/stocks/buy-my-vote-a-startup-is-letting-shareholders-sell-their-proxies-122f0eb9>.]

The upside to this idea is that it allows individual investors to monetize voting rights they are otherwise unlikely to use. The downside is . . . everything else. Decoupling voting rights from share ownership is a risky endeavor that a fiduciary should approach with an abundance of caution.