

MEMO# 34399

November 22, 2022

SEC Commissioner Peirce Speech on Fund Proxy Voting and Engagement

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TO: ICI Members SUBJECTS: Disclosure
ESG

Fund Governance RE: SEC Commissioner Peirce Speech on Fund Proxy Voting and Engagement

Commissioner Peirce recently delivered fund-related remarks, highlighting that each fund "is distinct from their investors, their asset managers, and the other funds in the same complex but that too often, funds' interests are treated as being identical to those of their managers, their shareholders, their investors, or other funds in the same complex."[\[1\]](#) Commissioner Peirce's remarks, which include her views on pass through voting, are summarized below.

Fund Advisers' Fiduciary Duty

Commissioner Peirce pointed out that an adviser's fiduciary duty does not run to an individual fund shareholder. The adviser's and the board's fiduciary duty run "to each fund as a whole, so the investor has no reason to expect the fund to cater to any objectives that she, or any other shareholder, individually may have that are out of sync with the fund's objectives.... Each fund's objective and disclosed strategy must guide the board and adviser in its actions with respect to that fund."

Funds' Proxy Votes

Commissioner Peirce then pointed out that "[s]ome asset managers, ... treat funds as an extension of themselves or as one with all the other funds they manage... Just as with investment decisions, fund voting decisions must be guided by the fund's best interests as assessed in relation to each fund's objective and strategy."[\[2\]](#)

Commissioner Peirce commented on the recent amendments to Form N-PX, stating that "requiring every fund to disclose its votes implicitly pressures funds to vote, even when voting is not in their best interest. A determination not to vote or always to vote in line with management might be the best approach. ... The rule's nudge effect is amplified because it serves as a monitoring mechanism for organizations to which an asset manager has

pledged to vote the shares of the funds it manages in a particular way. For example, if an asset management firm signed on to the Asset Managers Net Zero Initiative, it would agree to "[i]mplement a stewardship and engagement strategy, with a clear escalation and voting policy, that is consistent with our ambition for all assets under management to achieve net zero emissions by 2050 or sooner."

She also noted that "asset managers often have one set of specialists to make voting recommendations to all the funds it manages and these funds often default to a single voting."

Funds' Engagement

Commissioner Peirce noted that funds engage with portfolio companies and questioned how one adviser, bound by its fiduciary duty to such diverse clients, can speak with one voice. She also noted that "index funds raise unique problems for asset managers seeking to exercise their fiduciary duty and should disclose if it plans to vote the fund's shares and engage actively on the fund's behalf with the goal of changing how companies are run alongside the fund's objective and strategy. Index funds face important decisions about their voting policies, but those decisions must be guided by their fiduciary duty to the fund and the fund alone. Whatever approach they choose, they must disclose it and adhere to it. A fund that was seeking to stick to its passive nature could not vote at all, vote according to the recommendation of the company's management, or vote proportionately to all other shareholders of the company."

She then noted that "[o]thers favor "pass-through" voting, pursuant to which the fund seeks and follows guidance from fund shareholders. Essentially, this approach would allow shareholders ... to shape the fund's voting strategy. Some interested third parties worry about pass-through voting because it would empower fund investors to override fund managers on ESG issues." She also noted that "[p]ass-through voting, if not designed to ensure broad shareholder participation ... could empower a few activist shareholders whose interests are divergent from those of the fund to capture the fund's vote for their own ends."

With respect to index-based funds, Commissioner Peirce stated that "the fund's disclosures should state whether the fund will vote and, if it does, what principles it will follow in doing so. While voting disclosures are usually not in the fund prospectus, if the fund adopts a voting strategy that does not obviously align with the fund's objective and principal strategy, highlighting it in the prospectus where the objective and principal strategy are described could help investors find funds that match their preferences. Passive funds with activist voting strategies would seem to fit in this category." She then went on to note that "[e]nsuring that a fund's votes line up with its disclosures is not enough. The substance and frequency of engagement with public companies also need to line up with the disclosures and interests of the fund purportedly being represented in those meetings."

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Notes

[1] See Commissioner Hester M. Peirce, There's a Fund For That: Remarks before FINRA's Certified Regulatory and Compliance Professional Dinner (November 15, 2022), <https://www.sec.gov/news/speech/peirce-finra-remarks-111522>.

[2] Commissioner Peirce provided examples that would be inconsistent with this principle, including that "third-parties, with an interest in the outcome of a vote, might try to pressure advisers into voting the shares of all funds in a particular way. Some organizations successfully target asset managers and ask that the firms commit to use the resources under their control to achieve non-investment goals such as cutting global carbon emissions, halting the loss of biodiversity, and overseeing portfolio companies' political engagement.

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