

# SEC Staff Guidance Regarding Proxy Voting by Investment Advisors

## Introduction

On June 30, 2014, the U.S. Securities and Exchange Commission (SEC) issued its much-anticipated guidance on proxy advisory firms in the form of Staff Legal Bulletin No. 20 (SLB 20) from the Division of Investment Management and the Division of Corporation Finance.<sup>1</sup> The staff's guidance addresses both 1) investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms, and 2) the availability and disclosure requirements of exemptions to the federal proxy rules that are relied upon by proxy advisory firms.

The SEC's guidance is in response to increasing concerns in some circles about the role that proxy advisory firms like Institutional Shareholder Services and Glass Lewis play in proxy votes. Individuals hoping for tougher regulations in regard to proxy advisory firms will likely be disappointed in SLB 20 because the guidelines do not require proxy advisers to register as investment advisers, and the SEC makes no mention of advisers having to give companies advance reports, which are two recommendations that were touted by the corporate community. Consequently, the SEC's guidance does little to diffuse the ongoing debate as to the role of proxy advisory firms in corporate elections, and their influence will continue to concern companies.

## Investment Advisers

**Fiduciary Duty Compliance.** An investment adviser is a fiduciary that must cast votes in accordance with the client's best interests and the adviser's corresponding proxy voting policies. The SEC provided examples of how an adviser can demonstrate compliance with this mandate. An adviser could:

- Sample proxy votes to review whether they complied with the adviser's proxy voting policies;
- Review and sample proxy votes to determine if the shareholder proposal requires additional analysis; and
- Review at least annually the adequacy of its proxy voting policies and

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procedures to make sure they have been implemented effectively and continue to be designed to ensure that proxies are voted in the client's best interests.

**Voting Every Proxy Is Not Required.** An investment adviser and its client have flexibility in determining the scope of the adviser's obligation to exercise proxy voting authority.

- Subject to fiduciary obligations to vote proxies in the best interests of clients, the investment adviser and the client may agree to a variety of arrangements, including an agreement:
  - Not to vote proxies with respect to particular types of proposals;
  - To focus solely on specific types of proposals that are based on the client's preferences;
  - To abstain from voting proxies at all; and
  - To vote in a manner recommended by management of the issuer absent a determination by the investment adviser that a particular proposal should be voted in a different manner.

**Hiring a Proxy Advisory Firm.** An investment adviser has a duty to review the capabilities of any proxy advisory firm it hires. This includes reviewing whether the proxy advisory firm has the capacity and competency to adequately analyze proxy issues. In this regard, the SEC advises that an investment adviser should:

- Examine the adequacy and quality of the proxy advisory firm's staffing and personnel;
- Review the robustness of the proxy advisory firm's policies and procedures regarding its ability to ensure that its proxy voting recommendations are based on current and materially accurate information; and
- Consider material conflicts of interest of a proxy advisory firm.

**Ongoing Oversight of Proxy Advisory Firms.** After hiring a proxy advisory firm, an investment adviser must provide continuous oversight. This includes:

- Establishing and implementing measures reasonably designed to identify and address the proxy advisory firm's conflicts that can arise on an ongoing basis;

- Requiring that the proxy firm update the investment adviser on business changes the investment adviser considers relevant (e.g., with respect to the proxy advisory firm's capacity and competency to provide proxy voting advice), or conflict policies and procedures; and
- Taking reasonable steps to investigate proxy advisory recommendations that are found to be based on a material error and determine whether the proxy advisory firm is making an effort to reduce similar errors in the future.

## Proxy Advisory Firms

**Application of Federal Proxy Rules.** Generally, the furnishing of proxy advice by a proxy adviser is exempt from the information and filing requirements of the federal proxy rules if it complies with the requirements of exemptions contained in Rule 14a-2(b). These exemptions include:

- A person furnishing proxy voting advice to another person with whom a business relationship exists, subject to conditions.
  - A business relationship includes, for example, delivering financial advice in the ordinary course of business, provided that the proxy advice is supplemental to this relationship and does not include special commission or remuneration.
  - A proxy adviser must clearly disclose to the client whether it has a "significant relationship" or "material interest" that could present a conflict of interest.
- What constitutes a "significant" or "material interest" will be fact dependent
- Boilerplate disclosures are not sufficient
- Disclosure should enable the recipient to understand the nature and scope of the conflicted relationship
- Disclosure should enable the recipient to understand the possible steps to mitigate the conflict
- Disclosure should provide sufficient information to allow the recipient to make an assessment about the reliability of recommendations.



## Conclusion

In light of the SEC's guidance, investment advisers and proxy advisory firms should review, and if appropriate make changes to, their current policies and procedures. Any changes should be made before the start of the 2015 proxy season.

If you have any questions regarding the matters discussed in this client alert, please contact any of the lawyers listed below.

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<sup>1</sup> Staff Legal Bulletin No. 20 (June 30, 2014)

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