SEC provides guidance on investment advisers’ proxy voting responsibilities and proxy voting advice

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At an open meeting held on August 21, 2019, the Securities and Exchange Commission (“SEC” or the “Commission”) voted 3–2 along party lines to issue a set of interpretive releases relating to proxy voting by investment advisers and proxy advisory firms, including (1) guidance regarding investment adviser proxy voting responsibilities, focusing particularly on the use of proxy advisory firms (“Proxy Voting Guidance”)¹ and (2) an interpretation and related guidance regarding the applicability of the federal proxy rules to proxy voting advice provided by proxy advisory firms (the “Proxy Voting Advice Interpretation,” and together with the Proxy Voting Guidance, the “Releases”).² Intended to assist investment advisers in fulfilling their fiduciary obligations when voting proxies, especially where they retain proxy advisory firms for voting advice, and proxy advisory firms in meeting their compliance obligations under the federal proxy rules when providing non-ministerial voting services to their clients, the substantive guidance contained in the Releases does not, in general, represent a significant departure from guidance on these topics previously issued by the SEC staff (“Staff”) of the Divisions of Corporation Finance and Investment Management. The Releases will become effective upon publication in the Federal Register.

Notably, the Releases were approved without undergoing a notice and comment period or economic cost-benefit analysis, which are procedural requirements for Commission rulemaking and often precede the issuance of Commission interpretations and guidance. Even though not positive law, in publishing the Releases under the imprimatur of the Commission, the import of the guidance for regulated investment advisers, proxy advisory firms, and, potentially, corporations engaged in solicitations subject to the federal proxy rules is magnified. In public statements at the August 21 open meeting, Commission Chairman Jay Clayton and Commissioners Elad Roisman and Hester Peirce, each of whom voted to approve the Releases, were careful to note that the

Commission’s guidance does not create new substantive obligations or build a new regulatory regime, but instead reiterates and clarifies, updates, or expands upon principles and interpretations expressed in existing regulations and Staff guidance. As such, it was not considered necessary to comply with the procedural requirements of Commission rulemaking. Underscoring that point, Chairman Clayton called upon counsel from the Commission’s Office of General Counsel to confirm that the Releases did not constitute rulemaking and therefore did not trigger additional procedural requirements for adoption.

Dissenting Commissioners Robert Jackson and Allison Lee, however, each voiced concerns about the process and the adequacy of the analysis of the guidance’s potential impacts on the proxy voting process. Commissioner Lee, in her first appearance at an open meeting, also distinguished the adoption of Commission guidance from non-binding Staff interpretations and took exception to the characterization of the guidance adopted in the Releases as not creating new obligations, noting that “[t]he Commission has made a substantive policy choice without formally seeking input, justifying that choice to the public, or even identifying any benefits to investors.”

The Releases come at a time when the role of proxy advisory firms has reemerged as a governance hot topic, with calls for increased regulation coming from Congress in the form of proposed legislation, as well as from corporate issuers, industry groups, and business associations that argue that proxy advisory firms exert outsized influence over corporate democracy, particularly in the context of M&A transactions, contested elections, non-routine proposals, and executive compensation matters, with too little accountability and rampant and often undisclosed conflicts of interest. On the other side stand the shareholder advocates, institutional investors, and asset managers who have consistently opposed regulation of proxy advisory firms, contending that proxy advisors serve a variety of valuable functions, that they are satisfied with the quality of services provided, and that regulation would add cost and inefficiency without a commensurate benefit. Both sides soon may well have opportunities to again submit comments to the Commission in support of their positions. While adopting the Releases, the Commission indicated that the guidance represented a “first step” and that future proxy-related rulemaking proposals are contemplated, including amendments to the proxy rules to address the availability of proxy solicitation exemptions to certain information and filing requirements now commonly relied upon by proxy advisory firms, as well as amendments to the shareholder proposal submission and resubmission thresholds under Rule 14a-8 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

**Background**

Rule 206(4)-6 (the “Proxy Voting Rule”) under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), adopted by the Commission in 2003, requires an investment adviser that exercises proxy voting authority for its clients, among other things, to adopt policies and procedures designed to ensure that the adviser votes proxies in the clients’ best interests and to disclose to its clients information about those policies and procedures and how to obtain

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information about how the adviser has voted as the client’s proxy. Given the volume and time pressure associated with proxy voting, investment advisers routinely rely on proxy advisory firms to assist with fulfilling their proxy voting responsibilities.

A fundamental principle underlying the Advisers Act is that an investment adviser is a fiduciary and, as such, owes to its clients duties of care and loyalty. The duty of care requires an investment adviser to provide advice that it reasonably believes is in the best interest of its client, based on the client’s objectives. The duty of loyalty requires an investment adviser to not subordinate its clients’ interests to its own, to disclose all material facts relating to the advisory relationship, and to eliminate or make full and fair disclosure of all conflicts of interest which might render the adviser’s advice not disinterested and obtain from the client informed consent to the conflict. The Commission in June 2019 issued interpretive guidance (the “Fiduciary Interpretation”), which consolidated, reaffirmed, and clarified the Commission’s views regarding the fiduciary standard as it applies to the investment adviser–client relationship, but in that guidance refrained from addressing with specificity the requirements of an investment adviser’s duties in the context of proxy voting. The subsequently issued Proxy Voting Guidance makes clear that where an investment adviser has assumed the authority to vote on behalf of a client, the investment adviser must, among other things, have a reasonable understanding of the client’s objectives and make voting determinations that are in the best interest of that client. This also carries a responsibility to conduct an investigation reasonably designed to ensure that voting decisions are not based on materially inaccurate or incomplete information. Additionally, the investment adviser must make full and fair disclosures of any conflict of interest such that a client can provide informed consent to the conflict.

Since adoption of the Proxy Voting Rule, the Commission and the Staff have revisited issues underlying investment adviser proxy voting and the role of proxy advisory firms in a variety of ways, including engagement with the public through forums, public statements regarding investment adviser proxy voting responsibilities, in particular addressing the retention and use of proxy advisory firms, and issuance of Staff guidance. For example, in 2010, the Commission issued a concept release seeking public comment about a range of infrastructure and technical issues affecting the solicitation, voting, and tabulation of proxies in the U.S., including questions involving the role and regulatory status of proxy advisory firms. The Staff held a roundtable in December 2013 and six months later the Divisions of Investment Management and Corporation Finance issued Staff Legal Bulletin No. 20 (“SLB 20”) to provide the Staff’s views on investment advisers’ responsibilities in voting client proxies and retaining proxy advisory firms. More recently,

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5 See Rule 206(4)-6 under the Advisers Act, available at https://www.ecfr.gov/cgi-bin/text-idx?SID=10b81ff02704ee5320e89c84e01f2d&mc=true&node=se17.4.275_1206.24.3.668&rgn=div8.
7 Concept Release on the U.S. Proxy System, Release No. 34-62495 (July 14, 2010) (the “Proxy Plumbing Release”), available at https://www.sec.gov/rules/concept/2010/34-62495.pdf. Comment letters received in response to the Proxy Plumbing Release are available at https://www.sec.gov/comments/s7-14-10/s71410.shtml. While a number of these “proxy plumbing” topics resurface with some regularity for further discussion and calls to action, to date they have largely gone unaddressed from a legislative or regulatory reform rulemaking perspective.
8 The 2013 roundtable focused on topics related to the growth, nature, and impact of the proxy advisory industry and considered specifically conflicts of interest by proxy advisory firms and the accuracy and transparency of the vote recommendation process.
in November 2018, the Staff hosted a roundtable discussion on the proxy process that included a panel on the role of proxy advisory firms and their use by investment advisers.

The Commission issued the Releases after reviewing public feedback and comments received in connection with the 2018 proxy roundtable. The Releases follow the Q&A format used by the Staff in SLB 20 and other guidance involving flexible, principles-based approaches to compliance with Commission regulations. The Proxy Voting Guidance updates and expands upon many of the issues addressed in SLB 20, consistent with the principles underlying the guidance provided by the Commission in the recent Fiduciary Interpretation. Although SLB 20 remains outstanding, it is effectively overridden by the Releases.

**Proxy Voting Guidance**

The Proxy Voting Guidance recognizes that the scope of voting authority granted to the investment adviser will vary based on the nature of the client and the contours of the specific investment adviser–client relationship. In all cases, however, the investment adviser’s fiduciary duties extend to proxy voting and in that regard are proportional to the scope of voting authority granted to and accepted by the investment adviser. The Proxy Voting Guidance echoes the Fiduciary Interpretation and is explicit that the investment adviser’s duties as a fiduciary cannot be waived by a client or delegated to a third party. The onus thus remains squarely on the investment adviser to exercise due diligence and oversight with respect to the quality of services provided by any proxy advisory firm. The Proxy Voting Guidance provides six Q&A discussions highlighting the Commission’s views on how an investment adviser’s fiduciary duty and Rule 206(4)-6 relate to proxy voting on behalf of clients, especially where a proxy advisory firm is retained to assist with some aspect of the investment adviser's proxy voting responsibilities.

Key aspects of the Proxy Voting Guidance are highlighted below.

1. **An investment adviser and its client may shape the scope of voting authority to be exercised by the investment adviser by agreement, provided there is full and fair disclosure and informed consent.**
   - The Commission provides non-exhaustive examples of voting arrangements illustrating various possible decision rules and limitations to which an investment manager and client may agree, but clarifies that “[w]hile the application of the investment adviser’s fiduciary duty in the context of proxy voting will vary with the scope of the voting authority assumed by the investment adviser, the relationship in all cases remains that of a fiduciary to the client.”
   - An investment adviser is not required to assume voting responsibility, but remains at all times a fiduciary of the client.
   - In the absence of agreement otherwise, an investment adviser with discretionary investment authority over a client’s portfolio has implied responsibility for making voting determinations.

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2. An investment adviser must take steps to demonstrate that it is making voting
determinations in a client's best interest and in accordance with the adviser’s proxy voting
policies and procedures.
   — To fulfill its fiduciary duty, an investment adviser must conduct a reasonable investigation
into matters on which it votes.
   — An investment adviser with multiple clients having differing investment objectives and
strategies should consider whether a uniform voting policy would be in the best interest of
each of its clients.
   — Rule 206(4)-6 does not prevent an investment adviser from having different policies and
procedures for different clients or different categories of clients.
   — Certain types of matters (e.g., mergers and acquisitions, dissolutions, conversions,
consolidations, and contested director elections) may necessitate a more detailed analysis
than required by its general voting guidelines to consider factors particular to the issuer or
the voting matter under consideration.
   — An investment adviser should also consider reasonable measures to determine that it is
casting votes on behalf of its clients consistently with its voting policies and procedures by,
for example, sampling the proxy votes it casts on behalf of its clients as part of its annual
review of its compliance policies and procedures.
   — Adequacy of the investment adviser’s voting policies and procedures should be reviewed and
documented at least annually.
   — When retaining a proxy advisory firm to assist with its proxy voting obligations, before the
votes are cast, an investment adviser should take additional steps, such as sampling pre-
populated votes, to evaluate whether the voting determinations are consistent with its voting
policies and procedures and in the client’s best interest.

3. Before retaining a proxy advisory firm, an investment adviser should consider, among
other things, whether the proxy advisory firm has the capacity and competency to
adequately analyze the matters for which the investment adviser is responsible for voting.
   — Some factors to consider are: (1) the adequacy and quality of the proxy advisory firm’s
staffing, personnel, and/or technology; (2) the effectiveness of the process for seeking timely
input from issuers and clients (i.e., the investment advisers) (for example, with respect to its
proxy voting policies, methodologies, and peer group constructions); (3) the adequacy of
disclosure of the proxy advisory firm’s methodologies in formulating voting
recommendations; and (4) the nature of any third-party information sources used as the basis
for voting recommendations.
   — An investment adviser should also review the proxy advisory firm’s policies and procedures
regarding how to identify and address conflicts of interest. The depth of such considerations
depends on the scope of an investment adviser’s voting authority and the type of services the
proxy advisory firm is retained to perform.

4. An investment adviser’s policies and procedures should be reasonably designed to ensure
that its voting determinations are not based on materially inaccurate or incomplete
information.
   — For example, an investment adviser could periodically review its use of the proxy advisory
firm to assess the extent to which potential factual errors, incompleteness, or methodological
weaknesses in the analysis may materially affect the proxy advisory firm’s research or
recommendations.
— An investment adviser should also consider the effectiveness of the proxy advisory firm’s policies and procedures for obtaining current and accurate information relevant to make voting recommendations.

5. **An investment adviser should adopt and implement policies and procedures reasonably designed to sufficiently evaluate the proxy advisory firm in order to ensure that the investment adviser casts votes in the best interest of its clients.**
   — Steps to consider include evaluation of a proxy advisory firm’s conflicts of interest and updates of methodologies, guidelines, and voting recommendations on an ongoing basis.

6. **An investment adviser is not required to exercise every opportunity to vote proxies after assuming voting authority on behalf of a client.**
   — An investment adviser and its client can agree in advance to limit the conditions under which voting authority should be exercised.
   — An investment adviser with voting authority may also refrain from voting proxies on behalf of a client if it has determined that refraining is in the best interest of the client (e.g., in the case where the investment adviser has determined that the cost of voting would exceed the expected benefit to the client). In doing so, however, the investment adviser may not ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies and cannot fulfill its fiduciary responsibilities to its clients by merely refraining from voting.

**Proxy Voting Advice Interpretation**

The Proxy Voting Advice Interpretation reiterates and reinforces the Commission’s view that proxy voting advice provided by a proxy advisory firm generally constitutes a solicitation under the federal proxy rules and is prohibited by Exchange Act Rule 14a-9 from containing any false or misleading statement with respect to any material fact at the time and in the light of the circumstances under which it is made.

Under Rule 14a-1(l) of the Exchange Act, “solicitation” includes a “communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.”\(^{10}\) This applies broadly to communication made by any person seeking to influence the voting of proxies by shareholders, regardless of whether the person itself is seeking authorization to act as a proxy or whether the person seeking to influence the vote is indifferent to its ultimate outcome. The Commission believes that proxy advisory firm communication, if it reflects more than administrative or ministerial work, should be considered a solicitation even if it is based on application of a client’s own tailored voting guidelines and even in circumstances where the client may not follow the proxy advisory firm’s advice.

While proxy advisory firms may continue to rely on exemptions from the information and filing requirements under Exchange Act Rule 14a-2(b), the Proxy Voting Advice Interpretation confirms that proxy voting advice, considered as solicitation, is subject to the anti-fraud provisions under Exchange Act Rule 14a-9. The Commission further clarifies that Rule 14a-9 extends to opinions, reasons, and recommendations or beliefs disclosed as part of a solicitation, which may be

\(^{10}\) 17 CFR 240.14a-1(l)(iii).
statements of material facts and their underlying facts, assumptions, limitations, and other information may require disclosure. Accordingly, any person engaged in a solicitation through proxy voting advice must not make materially false or misleading statements or omit material facts, such as information underlying the basis of its advice or affecting analysis and judgments that would be required to make the advice not misleading.

The Commission notes three types of information proxy advisory firms should consider disclosing to avoid a potential Rule 14a-9 violation: (1) an explanation of the methodology used to formulate its voting advice on a particular matter; (2) disclosure about any third-party information sources and the extent to which such information materially differs from public disclosures; and (3) disclosure about material conflicts of interest arising in connection with providing the proxy voting advice.

What do I need to do now?

**Investment advisers:** In advance of the 2020 proxy season, investment advisers—and proxy advisory firms—should review their policies and practices in light of the guidance set forth in the Releases, and make any necessary modifications based on gaps identified. In general, the Proxy Voting Guidance tracks prior Staff guidance and market practice and requires reasonable due diligence and oversight, reasonably identifying and addressing conflicts, and full and fair disclosure.

**Public companies:** We expect the Releases to have little (if any) immediate impact on companies engaged in proxy solicitations in the upcoming proxy season. It is, however, possible that proxy advisory firms and investment managers will look for additional issuer input and engagement based on the results of their reviews of their own policies and practices in light of the views expressed in the Releases. In addition, in the event of an unfavorable proxy voting recommendation from ISS, Glass Lewis, or another proxy advisory firm, the Q&As included in the Releases will give company management a helpful roadmap to use in challenging such recommendations and seeking to cause investment advisers and institutional investors to make an independent voting decision. The ultimate impact (if any) that the Releases will have on the power and influence of proxy advisory firms and their industry remains to be seen.

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