

**MEMO# 31916**

August 22, 2019

# SEC Issues Proxy-Related Guidance to Investment Advisers and Proxy Advisory Firms

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August 22, 2019 TO: ICI Members  
Investment Company Directors SUBJECTS: Compliance  
Disclosure  
Fund Governance  
Intermediary Oversight  
Investment Advisers  
Operations

Transfer Agency RE: SEC Issues Proxy-Related Guidance to Investment Advisers and Proxy Advisory Firms

On August 21, the SEC issued proxy-related guidance to investment advisers<sup>[1]</sup> and proxy advisory firms.<sup>[2]</sup> Each item passed by a 3-2 vote, with Chairman Clayton and Commissioners Roisman and Peirce voting for the guidance,<sup>[3]</sup> and Commissioners Jackson and Lee voting against it.<sup>[4]</sup>

The Commissioners casting affirmative votes all highlighted that investment advisers are fiduciaries that owe each of their clients duties of care and loyalty with respect to proxy voting, and that the guidance is drafted to help them fulfill these duties.

The guidance will be effective upon publication in the Federal Register, and the SEC has encouraged investment advisers to review their policies and procedures in light of the guidance in advance of next year's proxy season.

## Summary of the Investment Adviser Guidance

Drawing from its prior regulatory actions,<sup>[5]</sup> the Commission reiterates that investment advisers owe each of their clients duties of care and loyalty with respect to services undertaken on their behalf, including proxy voting. It states that Advisers Act Rule 206(4)-6 requires an investment adviser to adopt and implement written policies and procedures reasonably designed to ensure that the adviser votes proxies in the best interest of its clients.

The guidance then focuses on how an investment adviser may satisfy these responsibilities, particularly if it retains a proxy advisory firm for proxy voting assistance. In Question and

Answer format, the guidance addresses the following broad subjects.

- **Setting the Scope of an Investment Adviser's Proxy Voting Responsibilities.**

An investment adviser and its client may agree upon the scope of the adviser's authority and responsibilities to vote proxies on the client's behalf. An adviser need not accept the authority to vote a client's securities,<sup>[6]</sup> and an adviser may employ a variety of arrangements in voting clients' proxies. The guidance provides the following "non-exhaustive examples" of possible arrangements:

- Voting within specific parameters designed to serve the client's best interest (e.g., voting in accordance with management's recommendations, or in favor of all proposals made by a particular shareholder proponent);
- Refraining from voting where doing so would impose costs on the client (e.g., opportunity costs from restricting the use of securities for lending to preserve the right to vote);
- Voting only on proposals based on the client's preferences (e.g., relating to corporate events (mergers and acquisition transactions, dissolutions, conversions, or consolidations) or contested director elections); or
- Refraining from voting on certain matters where the cost of voting would be high, or the benefit to the client would be low (e.g., voting a foreign security's proxy that could involve hiring a translator or traveling to a foreign country, or where voting would not reasonably be expected to have a material effect on the value of the client's investment).<sup>[7]</sup>

- **Demonstrating That Voting Is in a Client's Best Interest and in Accordance with Policies and Procedures.**

The guidance states that an adviser:

- Should consider how its obligations apply to its multiple clients, and whether voting all of its clients' shares in accordance with a uniform voting policy would be in the best interest of each;<sup>[8]</sup>
- Should consider whether certain matters may necessitate more detailed analysis than what may be entailed by application of its general voting guidelines (e.g., corporate events such as mergers and contested director elections);
- Should consider reasonable measures to determine that it is voting consistently with its policies and procedures (e.g., by sampling proxy votes as part of its annual review of compliance policies and procedures). Where an adviser retains a proxy advisory firm, this also could include:
  - Sampling pre-populated votes (i.e., reviewing how votes are pre-populated on the proxy firm's electronic platform before they are cast);
  - Considering additional information that may become available when the adviser utilizes a firm's recommendation (e.g., an issuer's or shareholder proponent's subsequently filed additional proxy materials or other information conveyed by such parties to the investment adviser that would reasonably be expected to affect the adviser's vote); and
  - For matters where the adviser's policies and procedures do not address how it should vote on a particular matter, or where the matter is highly contested or controversial (e.g., takeovers or contested director elections), considering whether a higher degree of analysis may be necessary; and
  - Must review and document, no less frequently than annually, the adequacy of its voting policies and procedures.

- **Considering Whether to Retain a Proxy Advisory Firm.**

Generally speaking, an adviser should consider whether the firm "has the capacity and competency to adequately analyze" the relevant voting matters (including, e.g., the adequacy and

quality of the firm's staffing, personnel, and/or technology).[\[9\]](#) This due diligence could depend on the functions and services that the firm would perform. Other considerations include:

- The firm's process for seeking timely input from issuers and firm clients on its proxy voting policies, methodologies, and peer group constructions (including for "say-on-pay" executive compensation votes);
- The adequacy of the firm's disclosures on its underlying methodologies, and when and how the firm engages with issuers and third parties; and
- The firm's policies and procedures for identifying and addressing conflicts of interest.[\[10\]](#)

- **Responding to Potential Errors, Incompleteness, or Methodological Weaknesses in the Firm's Analysis.** The adviser's policies and procedures should be reasonably designed to ensure that its voting determinations are not based on materially inaccurate or incomplete information. These procedures could include assessing the extent to which potential factual errors, incompleteness, or methodological weaknesses in the firm's analysis materially affected its research or recommendations. This assessment in turn could include consideration of the firm's:
  - Engagement with issuers, including the firm's process for ensuring that it has complete and accurate information about the issuer and each matter;
  - Efforts to correct any identified material analytical deficiencies;
  - Disclosure regarding the sources of information and methodologies used in formulating voting recommendations; and
  - Consideration of factors unique to a specific issuer or proposal.
- **Subsequently Evaluating the Services of a Proxy Advisory Firm.** The firm's business or policies and procedures (e.g., related to potential conflicts of interest) could change after the adviser has initially assessed and retained the firm, and therefore the adviser should consider requiring the firm to provide updates regarding relevant business changes.
- **Determining Whether to Vote Each Proxy.** An adviser need not vote every client proxy, if:
  - the adviser and client have agreed to limit the scope of the adviser's proxy voting responsibilities, as discussed above; or
  - it determines that refraining is in the client's best interest (e.g., where the cost exceeds the expected benefit to the client), consistent with the adviser's duty of care.

## **Summary of the Commission's Interpretation and Guidance for Proxy Advisory Firms**

The Proxy Advisory Firm Guidance first provides an interpretation and related guidance on whether proxy voting advice constitutes a "solicitation" under the proxy rules. It then applies Rule 14a-9 to proxy advisory firms' activities.[\[11\]](#)

First, the interpretation states that proxy voting advice provided by proxy advisory firms generally constitutes a solicitation subject to the proxy rules. The Commission reasons that proxy advisory firms provide voting recommendations with the expectation that those recommendations will assist clients with their voting decisions. The advice therefore is a solicitation because it is "a communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." The Commission similarly views as solicitations proxy advisory firm recommendations

based on its application of the client's own tailored voting guidelines.<sup>[12]</sup>

This interpretation does not affect proxy advisory firms' ability to rely on Rule 14a-2(b)'s exemptions from the proxy rules' information and filing requirements.<sup>[13]</sup>

Second, the Commission states that 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 which would affect its analysis or judgments, that would be required to make the advice not misleading." The interpretation then provides three examples of disclosure a proxy advisory firm should consider making to avoid violating Rule 14a-9:

- an explanation of the methodology used to formulate its voting advice on a particular matter (including any material deviations from the provider's publicly-announced guidelines, policies, or standard methodologies);
- if the advice is based on information other than the registrant's public disclosures (e.g., third-party information sources, disclosure about these information sources and material differences between them and the registrant's public disclosures); and
- disclosure about material conflicts of interest that arise in connection with providing the proxy voting advice in reasonably sufficient detail so that the client can assess the relevance of those conflicts.

## **Next Steps on Proxy Matters**

Commissioner Roisman noted in his prepared remarks that:

- In the "near future," the SEC expects to consider:
  - proposed amendments to the submission and resubmission thresholds for shareholder proposals under Rule 14a-8; and
  - proposed amendments to address proxy advisory firms' reliance on the proxy solicitation exemptions; and
- In the "longer-term," the SEC is expected to consider actions to modernize the proxy system to promote greater efficiency and accuracy in shareholder voting (i.e., improvements to "proxy plumbing").

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## **endnotes**

<sup>[1]</sup> SEC Release No. IA-5325, *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers* (Aug. 21, 2019) ("Investment Adviser Guidance"), available at [www.sec.gov/rules/interp/2019/ia-5325.pdf](http://www.sec.gov/rules/interp/2019/ia-5325.pdf).

<sup>[2]</sup> SEC Release No. 34-86721, *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice* (Aug. 21, 2019) ("Proxy Advisory Firm Guidance"), available at [www.sec.gov/rules/interp/2019/34-86721.pdf](http://www.sec.gov/rules/interp/2019/34-86721.pdf).

[3] Commissioner Roisman highlighted that the guidance: (i) updates and elevates prior staff guidance (in SLB 20)(see *infra*, note 5); and (ii) discusses whether an adviser is required to exercise every opportunity to vote when it has assumed voting authority on behalf of a client. Notably, he stated that the Commission had considered and rejected the notions of requiring investment advisers to pass through voting to their clients or restricting advisers' use of proxy advisory firms.

[4] Commissioner Jackson was primarily concerned that the guidance may alter the competitive landscape for the production and use of proxy advisory firm advice without addressing whether it might make it harder for investors to oversee management. He also pointed out that smaller investors might choose not to vote if voting becomes more expensive, which may result in larger institutions having greater influence.

Commissioner Lee was concerned that the guidance: (i) creates risks to the exercise of shareholders' votes by introducing increased costs and time pressure into an already compressed process; (ii) calls for more issuer involvement, which might undermine the reliability and independence of voting recommendations; (iii) was issued without notice and comment and without a cost/benefit analysis; and (iv) would impose new barriers to entry in an already concentrated proxy advisory firm market.

The Commissioners' statements are available at [www.sec.gov/news/statements](http://www.sec.gov/news/statements).

[5] Most notably, the Investment Adviser Guidance cites *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248 (June 5, 2019), 84 FR 33669; *Concept Release on the U.S. Proxy System*, Release No. 34-62495 (July 14, 2010), 75 FR 42982 (July 22, 2010); and *Proxy Voting by Investment Advisers*, Release No. IA-2106 (Jan. 31, 2003), 68 FR 6585 (Feb. 7, 2003) ("Proxy Voting Release"). While in some respects this new guidance most resembles SEC Staff Legal Bulletin No. 20, *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms* (June 30, 2014)("SLB 20"), the release pointedly states that SLB 20 "has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person." Investment Adviser Guidance at n.23. These and other proxy-related materials are available on ICI's website at [www.ici.org/proxy\\_voting](http://www.ici.org/proxy_voting).

[6] However, the guidance states that "to the extent an investment adviser has discretionary authority to manage the client's portfolio and has not agreed with the client to a narrower scope of voting authority through full and fair disclosure and informed consent, the adviser's responsibility for making voting determinations is implied." Investment Adviser Guidance at n.30.

[7] Cf. Proxy Voting Release at n.18 and accompanying text.

[8] For fund clients, the guidance notes that nothing "prevents an investment adviser from having different policies and procedures for different clients or different categories of clients" and that a fund board "could adopt and require an investment adviser to use policies and procedures that differ from those the adviser uses with respect to its other clients." Investment Adviser Guidance at n.40. Moreover, the guidance states that if funds have different voting policies and procedures, these differences should be reflected in the SAI or on Form N-CSR, as applicable.

[9] Cf. SLB 20, Question 3.

[\[10\]](#) Also, the guidance recommends that this review include assessing the firm's procedures to identify, adequately disclose (with sufficient details, context, and accessibility), and address the various types of conflicts to which the firms may be subject. See Investment Adviser Guidance at 19 for examples of these potential conflicts.

[\[11\]](#) Rule 14a-9 prohibits the making of false or misleading statements in proxy solicitations.

[\[12\]](#) Proxy Advisory Firm Guidance at 9. In contrast, the Commission does not view the proxy advisory firm's performance of merely "administrative or ministerial" services as a solicitation.

[\[13\]](#) As discussed below, however, the SEC staff is considering proposing amendments to these exemptions.

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