

SEC Publishes New Proxy Voting Guidance

By [The Investment Management Practice](#)

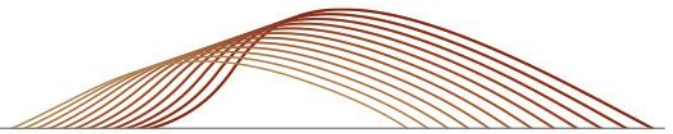
Introduction

On Wednesday, August 21, 2019, in a vote split down party lines, the Securities and Exchange Commission (the "SEC" or the "Commission") issued the long awaited guidance on proxy voting responsibilities of investment advisers under Rule 206(4)-6 under the Investment Advisers Act of 1940, as amended ("Advisers Act") and Forms N-1A, N-2, N-3 and N-CSR under the Investment Company Act of 1940, as amended ("Investment Company Act"). Furthermore, in a separate release, the Commission also issued guidance on the application of proxy rules to proxy advisory firms. Commissioners Robert Jackson and Allison Herren Lee voted against each interpretive guidance.

Background

Over the last few years concerns over the perceived influence of proxy advisory firms have grown. For example, in May 2018, six senators on the Banking, Housing, and Urban Affairs Committee sent letters to ISS and Glass Lewis with questions regarding their exemption from SEC proxy rules and their disclosure of the perceived conflicts of interest.¹ Furthermore, in September 2018, the Commission, in advance of the Roundtable on the Proxy Process (the "Roundtable"), withdrew two no-action letters issued in 2004: Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (Sept. 15, 2004). In withdrawing the two no-action letters the Commission noted that it hoped that the withdrawal would facilitate the discussion at the Roundtable. Moreover, the SEC was interested in receiving information and feedback from stakeholders with multiple perspectives at the Roundtable, including on the staff guidance in Staff Legal Bulletin No. 20 (June 30, 2014).²

After the Roundtable, Chairman Jay Clayton announced that Commissioner Roisman would lead the Commission's efforts to improve the proxy voting process and infrastructure. At the ICI Mutual Fund and Investment Management Conference, Commissioner Roisman noted that certain investment adviser practices with respect to proxy voting have raised questions, specifically "why some advisers (1) aim to vote every proxy for every company in every fund's portfolio; (2) centralize proxy voting functions within a complex and vote uniformly across funds in the complex; and (3) rely on third-party proxy advisory firms to assist with devising and implementing voting policies."³ He concluded his remarks by noting that in his opinion it was time for the SEC "to consider whether guidance would be helpful to asset managers as they consider how to utilize the services of proxy advisory firms. Relatedly, since proxy advisory firms rely on the proxy solicitation exemptions available under certain Exchange Act rules, it may be appropriate for the Commission to reassess whether their current practices fit within the intended scope and purpose of these exemptions."⁴

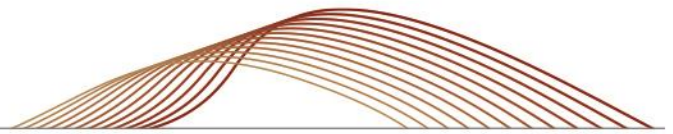


Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers (“Guidance”)

The Commission noted that the Guidance is meant to provide examples to help facilitate investment advisers’ compliance with their proxy voting responsibilities.⁵ The SEC also noted that the examples offered in the Guidance are not the only way by which investment advisers could comply with their principles-based fiduciary duty imposed on them by the Advisers Act. Furthermore, the Guidance notes that investment advisers and proxy advisory firms should review their policies and practices in light of the Guidance.

The Guidance highlights the following topics in the release:

- Because the fiduciary duty under the Advisers Act follows the contours of the relationship between an adviser and its client, and the adviser and its client may shape that relationship by agreement, an adviser and its client may agree that the adviser would not exercise voting authority in circumstances under which voting would impose costs on the client, for example, casting a vote on a foreign security that could involve the additional costs of hiring a translator or travelling to a foreign country to vote the security in person.
- An adviser and client may also agree that proxy voting authority would not be exercised on certain types of matters if the benefit to a client would be immaterial, such as circumstances under which casting a vote would not reasonably be expected to have a material effect on the value of a client’s investment.
- An adviser should take into account different investment strategies and objectives with respect to each of the clients it advises and whether different voting policies are necessary for such clients depending on the investment strategy and objectives of each client. For example, a growth fund that targets companies with high growth prospects may have a different perspective on certain matters submitted to shareholders than an income or dividend fund that seeks to generate an income stream for shareholders in the form of dividends or interest payments. Furthermore, the Guidance notes that registered investment companies that invest in voting securities are also required to disclose in their statements of additional information or on Form N-CSR, the policies and procedures that they use to determine how to vote proxies relating to securities held in their portfolios. Thus, if funds have different voting policies and procedures, these should be reflected in the SAI or on Form N-CSR.
- An adviser, no less frequently than annually, should review the adequacy of its voting policies and procedures to ensure that they have been formulated reasonably and implemented effectively, including whether the applicable policies and procedures continue to be reasonably designed to ensure that the adviser casts votes on behalf of its clients in the best interest of such clients.
- An adviser that retains a proxy advisory firm to assist in proxy voting should consider and evaluate the proxy advisory firm’s policies and procedures for obtaining current and accurate information relevant to matters included in its research and on which it makes voting recommendations.
- An adviser should also consider whether the proxy advisory firm appropriately updates its methodologies, guidelines, and voting recommendations on an ongoing basis, including in



response to feedback from issuers and their shareholders. For example, if an adviser becomes aware of potential factual errors, potential incompleteness, or potential methodological weaknesses in the proxy advisory firm's analysis, the 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.

- An adviser should conduct a reasonable review of the proxy advisory firm's policies and procedures regarding how it identifies, discloses and addresses conflicts of interest, including conflicts arising out of "the provision of recommendations and services to issuers as well as proponents of shareholder proposals," and conflicts from "activities other than providing proxy voting recommendations and proxy voting services." For example, consulting services, which the proxy advisory firm offers and certain affiliations, such as a third party with significant influence over the proxy advisory firm. Policies and procedures should be designed to identify and evaluate a proxy advisory firm's conflicts of interest that can arise on an ongoing basis.

Interpretation and Guidance Regarding the Applicability of the Proxy Rules ("Proxy Rules Guidance")

The Proxy Rules Guidance provides that consistent with past SEC statements, the definition of "solicitation" may result in proxy advisory firms being subject to the proxy rules because a proxy advisory firm provides recommendations that are reasonably calculated to result in the procurement, withholding, or revocation of a proxy.⁶ The Proxy Rules Guidance further notes that proxy advisory firms can use an exemption from the information and filing requirements of the proxy rules, nonetheless such solicitations would remain subject to the antifraud provisions of Rule 14a-9.⁷ The Proxy Rules Guidance notes that a proxy advisory firm should consider whether, to avoid a potential violation of Rule 14a-9, it may need to disclose an explanation of the methodology used to formulate its voting advice (including any material deviations from its publicly announced guidelines, policies, or standard methodologies); the proxy advisory firm's use of any information sources that differ from the public disclosures provided by an issuer; and information about material conflicts of interest that arise in connection with providing the proxy voting advice.

More specifically, with regard to methodology, the guidance advises that, if the advice is "materially based on a methodology using a group of peer companies selected by the proxy advisory firm, the disclosure may need to include the identities of the peer group members used as part of its recommendation and the reasons for selecting these peer group members as well as, if material, why its peer group members differ from those selected by the registrant. For example, such disclosure may be needed for a voting recommendation on a registrant's advisory vote on an executive compensation proposal that is based on a comparison of the registrant's executive compensation policies to those of other companies selected by the proxy advisory firm."

Conclusion

In her dissent, Commissioner Allison Lee noted "[a]lthough the release states that the very detailed approaches to assessing a proxy advisory firm are just examples of how an investment adviser could meet its fiduciary duties with respect to proxy voting, many of those examples are presented as steps the adviser in fact should take. A regulated entity ignores such direction at its peril. It may be that some of these specific measures are warranted, but the Commission has made a substantive policy choice without formally seeking input, justifying that choice to the public, or even identifying any benefits for investors."⁸



In contrast, Commissioner Hester Peirce noted that the Guidance is “not building a new regulatory regime.”⁹ Instead, she characterized the Guidance as “explaining the contours of an existing one to help investment advisers and proxy advisers carry out their responsibilities.”¹⁰ The Commissioner views the Guidance as a “welcome departure from our past over-reliance on staff guidance,” noting that the Guidance does not “prescribe what investment advisers and proxy advisers must do to carry out their responsibilities, but they describe some things these firms might consider to help them accomplish those goals.”¹¹

Chairman Jay Clayton, in his remarks, noted that the “staff is also considering potential recommendations that the Commission propose rule amendments to Rule 14a-2(b), the rule which provides exemptions from the information and filing requirements of the federal proxy rules. Two of these exemptions commonly relied upon by proxy advisory firms were adopted decades ago and warrant a fresh look to determine whether changes are needed.” He further noted that the SEC should consider whether the current rule definition of the term “solicitation” under the federal proxy rules should be amended to codify today’s interpretation.¹²

The Guidance and Proxy Rules Guidance are not subject to notice and comment, and will instead become effective upon publication in the Federal Register.

The SEC’s press release can be found [here](#).

The full text of the SEC’s Guidance and Proxy Voting Guidance can be found at the following links: [Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules](#) and [Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers](#).



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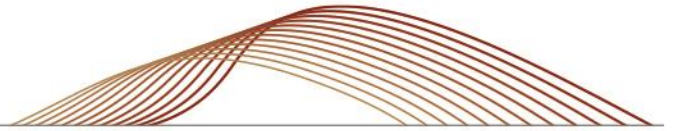
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- ¹ See Banking, Housing, and Urban Affairs Committee letter to ISS available at <http://www.wlrk.com/docs/SenateBankingCommitteeMembersInstitutionalShareholderServices.pdf>; letter to Glass Lewis available at <http://www.wlrk.com/docs/SenateBankingCommitteeMembersGlassLewisandCompany.pdf>.
 - ² Staff Legal Bulletin No. 20 ("SLB 20") provided guidance with respect to responsibilities of investment advisers in voting client proxies and retaining proxy advisory firms. In the Guidance, the SEC noted that "SLB 20 represents the views of the staff of the Divisions of Investment Management and Corporation Finance. It is not a rule, regulation, or statement of the Commission. Furthermore, the Commission has neither approved nor disapproved its content. SLB 20, like all staff guidance, 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."
 - ³ Keynote Remarks: ICI Mutual Funds and Investment Management Conference (March 18, 2019), available at <https://www.sec.gov/news/speech/speech-roisman-031819>.
 - ⁴ Keynote Remarks: ICI Mutual Funds and Investment Management Conference (March 18, 2019), available at <https://www.sec.gov/news/speech/speech-roisman-031819>.
 - ⁵ See generally SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice (August 21, 2019), available at <https://www.sec.gov/news/press-release/2019-158>.
 - ⁶ Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice Release No. 34-86721 (August 21, 2019) ("Proxy Rules Guidance"), pp. 6.
 - ⁷ Proxy Rules Guidance at 11.
 - ⁸ Statement of Commissioner Allison Herren Lee On Proxy Voting and Proxy Solicitation Releases (August 21, 2019), available at <https://www.sec.gov/news/public-statement/statement-lee-082119>.
 - ⁹ Statement at Open Meeting on Commission Guidance Regarding Proxy Voting and Proxy Voting Advice (August 21, 2019), available at <https://www.sec.gov/news/public-statement/statement-peirce-082119>.
 - ¹⁰ *Id.*
 - ¹¹ *Id.*
 - ¹² Statement of Chairman Jay Clayton On Commission Guidance and Interpretation Regarding Proxy Voting and Proxy Voting Advice (August 21, 2019) available at <https://www.sec.gov/news/public-statement/statement-clayton-082119>.

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