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Securities Law ADVISORY ■

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SEC Issues Guidance on Investment Advisers' Proxy Voting Responsibilities and Proxy Advisory Firms

On August 21, 2019, the Securities and Exchange Commission (SEC) issued guidance that outlines proxy voting responsibilities for investment advisers under Rule 206(4)-6. The SEC also issued a separate guidance and interpretation of the federal proxy rules that clarifies when voting advice from proxy advisory firms qualifies as a solicitation.

The SEC previously issued guidance in 2014 requiring proxy advisory firms to disclose material conflicts of interest and instructing investment advisers to monitor whether voting recommendations are in the best interests of their clients. Proxy advisory firms have come under further scrutiny since then, particularly by corporations and trade groups that criticize the firms' outsized influence on corporate decision-making, failure to disclose conflicts of interest, and inclusion of erroneous information in adviser reports. The SEC guidance appears to address these concerns without directly regulating proxy advisory firms.

Best Practices for Proxy Voting

As fiduciaries, investment advisers owe their clients duties of care and loyalty when acting on a client's behalf, such as voting proxies. To satisfy their duty of care, investment advisers must make proxy voting determinations that are in the best interests of their clients. In addition, pursuant to Rule 206(4)-(6) of the Investment Advisers Act, investment advisers must adopt and implement written policies and procedures that are reasonably designed to promote their clients' best interests. The SEC's new guidance discusses additional considerations investment advisers should account for when implementing their proxy voting policies and procedures.

Tailored voting policies and procedures

As the guidance suggests, advisers representing multiple clients should examine whether their voting policies are promoting the best interests of each of their clients, especially if the adviser currently implements a uniform voting policy. Advisers should consider their clients' varying objectives in deciding whether to implement specific policies and procedures for certain clients or different categories of clients. In particular, advisers representing multiple funds or pooled investment vehicles may need to tailor their voting policies to account for the varying investment strategies of each fund or pool.

Additional investigation into voting matters

To satisfy their duty of care, investment advisers must also conduct a reasonable investigation into voting matters to ensure that their vote is not based on materially inaccurate or incomplete information. To this end, advisers should

consider whether certain types of proposals, such as a merger vote, require additional investigation into an issuer and other relevant information. Reliance on a proxy advisory firm's recommendation or analysis may warrant additional investigation by an investment adviser to verify the basis for the advisory firm's advice.

Sampling proxy votes

Advisers must also review and document the adequacy of these policies and procedures for proxy voting at least once a year, pursuant to Rule 206(4)-(6). The guidance suggests "sampling" proxy votes as one method of self-evaluation for purposes of an adviser's annual review of its policies and procedures. For example, an adviser might sample the votes it has cast for all merger and acquisition proposals in order to assess whether it has consistently been voting in its clients' best interests. Sampling is also a viable method for assessing the adequacy of proxy advisory firms' voting recommendations and analysis.

Defining the scope of proxy voting authority

Once an investment adviser assumes voting authority, it is not required to exercise every opportunity to vote a proxy for a client. As the guidance suggests, an investment adviser and client may agree to limit the scope of the adviser's voting authority in various ways, subject to full and fair disclosure by the adviser and informed consent by the client. An adviser and client might agree that the adviser will only vote on certain matters while the client retains voting authority for others. For example, an investment adviser and client might agree that the adviser will only vote on non-major corporate events, while the client retains its voting responsibility for mergers or dissolutions.

An adviser and client could agree that the adviser will abstain from voting at all under certain situations, such as when voting the securities would incur a high cost to the client or result in little benefit to the client. For example, if voting a proxy would prevent a client from using the securities for lending, an adviser might abstain if it determines that the opportunity cost of restricting the securities for lending would be too great.

The guidance specifically notes, however, that advisers should carefully consider the scope of their voting responsibilities and whether they are satisfying their duty of care when refraining from voting.

Additional Considerations When Retaining Proxy Advisory Firms

An investment adviser should take additional steps when retaining a proxy advisory firm for research or voting recommendations. Advisers should have policies and procedures in place for evaluating the retained proxy advisory firm or any other third party that substantively assists in the adviser's proxy voting duties.

Specifically, investment advisers should assess:

- Whether the proxy advisory firm has the ability to adequately analyze proxy voting matters, taking into account the firm's staffing, personnel, and technology.
- Whether the firm has an effective process for seeking timely input into the firm's proxy voting policies, methodologies, and peer-group constructions.
- Whether the firm has adequately disclosed its methodologies in formulating voting recommendations.
- The nature of any third-party information sources used as a basis for voting recommendations.
- The firm's policies and procedures for addressing and disclosing conflicts of interest.
- The firm's policies and procedures for obtaining current and accurate information in its research for voting recommendations.

If an investment adviser is made aware of potential issues with the proxy advisory firm's analysis that might materially affect the investment adviser's voting determination, it should conduct a reasonable investigation into the nature of these issues.

Applicability of Federal Proxy Rules to Proxy Voting Advice

Pursuant to Rule 14a-1(1) of the Exchange Act, "solicitations" include communications that are "reasonably calculated" to influence a security holder's voting decision. In its interpretation of the proxy rules, the SEC clarifies that this definition applies even if the party offering such advice is not seeking to influence a proxy for itself or is indifferent to the outcome of the vote. Accordingly, the SEC concludes that proxy voting advice proffered by a proxy advisory firm generally qualifies as a solicitation since these firms expect their advice to be utilized by investment advisers voting on behalf of their clients. Proxy voting advice is generally considered a solicitation even when the advice is specifically tailored to a client's voting guidelines. Such advice may be a solicitation even if a client ultimately chooses not to follow the firm's recommendation.

Proxy voting advice is generally subject to the restrictions and exemptions that apply to solicitations under the federal proxy rules. For example, proxy voting advice is subject to Rule 14a-9 of the Exchange Act, which prohibits solicitations from containing false or misleading statements about any material fact.

Proxy voting advice is also subject to solicitation exemptions such as Rules 14a-2(b)(1) and (3) of the Exchange Act. Under Rule 14a-2(b)(1), a solicitation made by or on behalf of a person who does not seek to directly or indirectly influence a proxy at the time of the solicitation is not subject to the various information and filing requirements under Rule 14a. Rule 14a-2(b)(3) exempts solicitations made to a person with whom the maker of the solicitation (the "advisor") has a business relationship, so long as the advisor renders financial advice in the ordinary course of its business, discloses to the recipient material conflicts of interest, receives no special commission for rendering the advice from any person other than the recipient, and does not furnish the proxy voting advice on behalf of any other person soliciting proxies on behalf of a participant in a vote to elect or remove directors. Proxy advisory firms can invoke these exemptions to avoid the information and filing requirements associated with solicitations.

Impact on Proxy Advisory Firms

The impact of this guidance on proxy advisory firms remains to be seen. It also remains to be seen whether this guidance will help quell some of the criticism of proxy advisers by public companies. However, it is likely that the proxy advisers will refine their policies and procedures to ensure that they can satisfy the factors the investment advisers are required to assess.

Next Steps

The SEC's guidance will become effective 30 days after publication in the *Federal Register*. In light of this latest guidance, investment advisers should reexamine their existing proxy voting policies and procedures with the above considerations in mind. Alston & Bird is prepared to assist advisers in reviewing and updating their policies and procedures in light of this guidance.

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