

SEC Clarifies Investment Advisers' Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice



ALERT | August 26, 2019

Christopher M. Trueax | trueaxc@pepperlaw.com

On August 21, the Securities and Exchange Commission issued guidance to clarify investment advisers' fiduciary obligations when voting client proxies. On the same day, the SEC also issued an interpretation of Rule 14a-1(l) under the Securities Exchange Act of 1934 that proxy voting advice constitutes "solicitation" under the federal proxy rules. In that interpretive guidance, the SEC clarified that the antifraud provisions of Rule 14a-9 apply to proxy advice. While the new guidance does not impose any additional responsibilities on investment advisers or their administrative service providers, it does clarify the scope of their existing obligations and suggests instances where advisers and their service providers should consider whether enhancements to the process for fulfilling their existing obligations may be appropriate. The guidance is effective as of its publication in the *Federal Register*.

THIS PUBLICATION MAY CONTAIN ATTORNEY ADVERTISING

The material in this publication was created as of the date set forth above and is based on laws, court decisions, administrative rulings and congressional materials that existed at that time, and should not be construed as legal advice or legal opinions on specific facts. The information in this publication is not intended to create, and the transmission and receipt of it does not constitute, a lawyer-client relationship. Please send address corrections to phinfo@pepperlaw.com.

© 2019 Pepper Hamilton LLP. All Rights Reserved.

Guidance on Proxy Voting Responsibilities of Investment Advisers

The SEC's guidance on investment advisers' proxy voting responsibilities is designed to address the scope of their fiduciary obligations to their clients and assist them in adhering to those obligations. The guidance notes that investment advisers "are fiduciaries that owe each of their clients duties of care and loyalty with respect to services undertaken on the client's behalf." Those fiduciary duties extend to voting proxies if the investment adviser accepts responsibility to do so.¹ With respect to voting, this fiduciary duty is proportional to the scope of voting authority a client grants the investment adviser (and that the investment adviser agrees to accept), and it requires the investment adviser to use that authority to vote in the client's best interests. The guidance discusses the interplay of these fiduciary obligations with the requirement of Rule 206(4)-6 under the Investment Advisers Act of 1940 that investment advisers vote proxies pursuant to written policies and procedures that are reasonably designed to ensure voting is done in the best interests of clients.

In issuing the guidance, the SEC was motivated by its interest in how these fiduciary duties and written proxy policies and procedures may be affected when investment advisers delegate proxy voting responsibilities to third parties, particularly proxy advisory firms. The guidance provides a number of factors and considerations that investment advisers should evaluate and apply when using proxy advisory firms to vote client proxies.

The SEC's guidance is conveyed in a question and answer format. Some of the questions and corresponding advice contained in the guidance include:

- *How can an investment adviser and its client agree on the scope of the investment adviser's authority and responsibility with respect to voting that client's proxies?*
The SEC notes that the scope of this authority and responsibility is the product of an agreement between the parties, provided there is full disclosure and informed consent. Accordingly, an investment adviser can tailor the scope of responsibility it is willing to accept and, in fact, is not required to accept this responsibility, though at all times it remains a fiduciary of the client.
- *What steps can an investment adviser that has assumed authority to vote proxies on behalf of a client take to demonstrate that it makes voting determinations in the client's best interests and in accordance with its written proxy policies and procedures?*
Investment advisers may need to take reasonable investigations into proxy voting matters and consider whether certain items require more careful analysis. The SEC also recommends that investment advisers using proxy advisory firms take additional steps, such as sampling pre-populated votes or conducting a deeper analysis.

- *What are some of the considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist with its proxy voting responsibilities?* An investment adviser should assess, among other things, the adequacy and quality of the proxy advisory firm's staffing, personnel and/or technology in order to evaluate its overall ability to analyze the matters to be voted on. An investment adviser should also consider whether the proxy firm has adequately disclosed its methodologies in formulating voting recommendations and the nature of any third-party information sources it uses to make voting recommendations. The investment adviser should also make a reasonable review of the proxy advisory firm's policies and procedures regarding conflicts of interest.
- *What steps should an investment adviser that retains a proxy advisory firm take when it identifies errors or problems with respect to the proxy firm's methodologies, practices or policies?* An investment adviser should ensure its own proxy voting policies and procedures are reasonably designed to ensure that its voting determinations are not based on materially inaccurate or incomplete information.

While the guidance does not impose new affirmative obligations on investment advisers, taken as a whole, it emphasizes investment advisers' fiduciary obligations and encourages compliance with those obligations by focusing time and energy on the written policies and procedures required by Rule 206(4)-6 under the Advisers Act. The guidance also encourages investment advisers to ensure they are fully informed about the quality and record of any proxy advisers they may retain, and to take the time and resources to diligently investigate proxy voting matters that may require significant attention.

Interpretation and Guidance on the Applicability of the Federal Proxy Rules to Proxy Voting Advice

The SEC also released on August 21 interpretive guidance affirming that the federal proxy rules apply to any solicitation for a proxy with respect to registered securities. This interpretive guidance, also provided in the form of questions and answers, addresses the general applicability of section 14(a) of the Exchange Act to solicitations for proxies, which it interprets to include advice provided by proxy advisory firms. The SEC drew on the broad definition of "solicitation" under the Exchange Act (defined in Rule 14a-1(l) thereunder), which means "a communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." Because proxy advisory firms provide advice with respect to proxy matters in the form of a description and recommended vote, in order to assist investment advisers in their fiduciary obligations to investors, the SEC believes that proxy advice should be considered a solicitation and subject to the federal proxy rules.

The August 21 interpretive guidance affirms that proxy advisory firms may take advantage of the exemptions from the information and filing requirements of the federal proxy rules, found in Exchange Act Rule 14a-2(b). These exemptions, among other things, provide relief from the requirement to file a proxy statement.

Among other significant items presented in the interpretive guidance, the SEC affirmed that Exchange Act Rule 14a-9 applies to proxy voting advice. Rule 14a-9 prohibits solicitations from containing any false or misleading statements or omissions with respect to any material fact. The rule also covers opinions, reasons, recommendations or beliefs, which the SEC noted can, in some instances, constitute statements of material fact.

Because of this obligation, the SEC noted that proxy advisory firms may need to provide more information about their underlying methodologies and the source of information used to generate proxy advice in order to comply with Rule 14a-9. In particular, the SEC encouraged proxy advisory firms to consider disclosing “an explanation of the methodology used to formulate its voting on a particular matter . . . where the omission of such information would render the voting advice materially false or misleading” and sources of information underlying the advice beyond publicly available information. Proxy advisory firms may also need to consider whether to disclose material conflicts of interest that arise in connection with proxy advice.

* * *

The SEC’s press release, which contains links to the guidance and interpretive guidance, is available at <https://www.sec.gov/news/press-release/2019-158>.

Endnote

- 1 It should be noted, however, that the SEC’s view in the guidance is that an investment adviser with discretionary authority to manage a client’s portfolio has implied responsibility for proxy voting unless the investment adviser affirmatively agrees, through full and fair disclosure, with the client to not take on that responsibility, and receives informed consent from the client. This means that investment advisers should affirmatively address the scope of their intended proxy voting responsibilities with their clients and recognize they will be deemed to have that responsibility unless they seek to waive it through agreement with their clients.