

Securities Regulation and Compliance Alert

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SEC Staff Issues Guidance on Proxy Voting Matters Relevant to Investment Advisers and Proxy Advisory Firms

The U.S. Securities and Exchange Commission's (SEC) Divisions of Investment Management and Corporation Finance issued a Staff Legal Bulletin on June 30, 2014 that provides guidance on the responsibilities of investment advisers and proxy advisory firms in proxy voting matters. The [guidance](#), which is contained in answers to 13 key questions, is the long-awaited response to certain of the issues identified by the SEC in its study of the U.S. proxy voting system.

In July 2010, the SEC issued a [Concept Release on the U.S. Proxy System](#) in which it requested public comment on, among other things, steps that it could take to address concerns regarding the practices of investment advisers and proxy advisory firms. Those concerns included whether investment advisers were following reasonable policies and procedures when voting client securities, hiring proxy advisory firms and evaluating voting recommendations from the advisory firms. The concerns also included whether proxy advisory firms were properly relying on exemptions from the U.S. proxy rules. The SEC received additional feedback on these concerns at a [roundtable](#) it hosted in November 2013.

Although the Staff Legal Bulletin noted that "investment advisers and proxy advisory firms may want or need to make changes to their current systems and processes in light of" the staff's guidance, it is unlikely that any changes to conform to the guidance will have a significant impact on the current proxy voting system. The SEC would need to revise or adopt rules — which it has not indicated it intends to do — to make the more significant changes to the system that some commenters have suggested. Nevertheless, any changes to the oversight of proxy advisory firms and disclosure about their conflicts of interest that result from the staff guidance will be welcomed.

Following is a summary of the guidance in the Staff Legal Bulletin, a copy of which is available [here](#).

Proxy Voting Responsibilities of Investment Advisers. The first five questions the SEC staff answered in the Staff Legal Bulletin relate to the responsibility of investment advisers in proxy voting matters. The guidance addresses:

- The steps an investment adviser can take to demonstrate that proxy votes are cast in accordance with its clients' best interests and the adviser's proxy voting procedures;
- Whether an investment adviser is required to vote every proxy;
- The considerations an investment adviser may wish to take into account if it retains a proxy advisory firm to assist it in its proxy voting duties;
- Whether an investment adviser has an ongoing duty to oversee a proxy advisory firm that it retains; and

- The investment adviser's duties when it retains a proxy advisory firm with respect to the material accuracy of the facts upon which the proxy advisory firm's voting recommendations are based.

The guidance provided in response to these points generally confirmed industry views. The gloss provided in the SEC staff's answers, however, does impact earlier staff guidance issued in two no action letters¹ about the steps investment advisers can take to demonstrate that proxy votes are cast in accordance with their clients' best interests and the adviser's proxy voting procedures. As a result of this guidance, advisers most likely will need to take additional steps. The guidance identified what those steps could include, such as sampling and reviewing past proxy votes on an ongoing basis to see if the votes complied with the advisers' policies and procedures and reviewing proxy voting policies at least once a year. The guidance also provided examples of factors investment advisers could consider when assessing whether the proxy advisory firms they retain have the "capacity and competency" to analyze the proxy issues. Those factors include considering the proxy advisory firm's personnel, potential conflicts of interest and policies to ensure the firm makes recommendations based on accurate information.

Investment advisers should confirm that their policies and procedures properly address the new guidance and, if not, whether changes to policies and procedures should be made to address the guidance.

Availability of Exemptions From the Proxy Rules for Proxy Advisory Firms. The remaining eight questions the SEC staff answered in the Staff Legal Bulletin relate to the application of the SEC's proxy rules to the services proxy advisory firms typically provide their clients. The guidance addresses:

- When a proxy advisory firm is subject to the federal proxy rules;
- When a proxy advisory firm may rely on exemptions from the federal proxy rules; and
- The steps a proxy advisory firm must take to rely on available exemptions from the federal proxy rules.

Again, the guidance provided in response to these points generally confirmed industry views. The SEC staff's answers to these questions did, however, provide some new gloss that will most likely impact the types of disclosures that proxy advisory firms will provide their clients when issuing voting recommendations and the timing and method of when those disclosures will be provided. For instance, the guidance notes that when an advisory firm identifies a "material interest" or "significant relationship" with the company, its affiliates or a security holder proponent of a matter to be voted on, the firm has an affirmative duty to provide notice of the interest or relationship to the client at or about the same time the client is given the advice. The guidance also clarifies that the advisory firm needs to provide sufficient information for the client to understand the "nature and scope of the relationship or interest" and assess "the reliability or objectivity of the recommendation." Boilerplate language that a relationship or interest may or may not exist no longer will be sufficient in the view of the SEC staff. Furthermore, the SEC staff believes that determinations regarding materiality and significance should be made based on whether "knowledge of [the interest or relationship] would reasonably be expected to affect the recipient's assessment of the reliability and objectivity of the adviser and advice." Factors that the staff identified as likely to be considered in determining whether an interest or relationship is "material" or "significant" include the type of service being offered, the amount of compensation for the service and the connection between the advice and transaction giving rise to the relationship or interest.

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As noted above, the SEC staff stated that investment advisers and proxy advisory firms may need to make changes to their processes and systems as a result of the guidance. The staff stated that any such changes should be made "promptly," meaning at least "in advance of next year's proxy season." We will continue to monitor developments in this area and provide any relevant updates regarding the guidance and its impact. A copy of the guidance is available [here](#).

¹ SEC No Action Letter to Egan-Jones Proxy Services (May 27, 2004); SEC No Action Letter to Institutional Shareholder Services, Inc. (Sept. 15, 2004).