

SEC Provides Guidance on Investment Advisers' Proxy Voting Responsibilities, Proxy Voting Advice Rules

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On August 21, 2019, the Securities and Exchange Commission (SEC), by a 3-2 vote, issued two separate releases providing interpretive guidance relating to the proxy voting process. One release addresses the proxy voting responsibilities of investment advisers, particularly with respect to their use of advice from proxy advisory firms such as Institutional Shareholder Services (ISS) and Glass Lewis. The other release addresses the applicability of the proxy solicitation and anti-fraud rules to the voting recommendations issued by proxy advisory firms.¹

Companies Are Likely to See Little or No Near-Term Impact and May Experience Unintended Consequences

Although noteworthy, the SEC's guidance relates to investment advisers and proxy advisory firms, not to companies soliciting proxies. The guidance may result in investment advisers and proxy advisory firms reexamining and enhancing their policies, procedures and practices, but it does not alter the existing dynamic in which companies should be cognizant of proxy advisory firm voting guidelines and the potential for negative voting recommendations from ISS or Glass Lewis to meaningfully impact proxy voting results.

In fact, it is possible that the guidance may have a number of unintended consequences. For example, additional procedures adopted by proxy advisory firms may result in voting recommendations being issued closer to meeting dates, providing companies with less time to respond and try to sway stockholder votes. Further, investment advisers adopting additional policies to ensure that their use of proxy advisory firm recommendations is consistent with their fiduciary duties to clients may become less willing to vote contrary to the recommendations of proxy advisory firms. In addition, the guidance could have the effect of reducing stockholder voting and thereby enhancing the impact of proxy advisory firm recommendations and those stockholders that do vote, including activist investors.

Proxy Voting Responsibilities of Investment Advisers

In the release relating to proxy voting responsibilities and fiduciary duties of investment advisers, the SEC emphasized that "[i]nvestment advisers are fiduciaries that owe each of their clients duties of care and loyalty with respect to services undertaken on the client's behalf, including voting." In particular, the SEC stated that where an investment adviser has assumed the authority to vote on behalf of its client, the investment adviser, among other things, must have a reasonable understanding of the client's objectives and must make voting determinations that are in the best interest of the client. The SEC also noted that for an investment adviser to form a reasonable belief that its voting determinations are in the best interest of the client, it should conduct an investigation reasonably designed to ensure that the voting determination is not based on materially inaccurate or incomplete information.

The release, structured in a Q&A format, discusses the following topics:

- The ability of an investment adviser and its client, in establishing their relationship, to agree to a variety of different proxy voting arrangements, so long as there is "full and fair disclosure and informed consent."

¹ Additional information is available in the [SEC's press release](#).

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- Methods by which an investment adviser that has assumed voting authority can demonstrate that it is making voting determinations in its client's best interest and in accordance with its own proxy voting policies and procedures.
- Certain considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist it in discharging its proxy voting duties, such as whether the proxy advisory firm: (1) is capable of adequately analyzing matters for which the investment adviser is responsible for voting; (2) has an effective process for seeking timely input from issuers and proxy advisory firm clients; (3) has adequately disclosed its methodology in formulating voting recommendations to the investment adviser; and (4) has policies and procedures for identifying and addressing conflicts of interest.
- When retaining a proxy advisory firm, the steps an investment adviser should consider taking to address potential factual errors, incompleteness or methodological weaknesses in the proxy advisory firm's analysis that may materially affect the investment adviser's voting determinations.
- The adoption and implementation of policies and procedures that are reasonably designed to sufficiently evaluate the proxy advisory firm.
- Whether an investment adviser that has assumed voting authority on behalf of a client is required to exercise every opportunity to vote. In particular, the SEC identified the following two situations where an investment adviser would not be required to exercise voting authority it has assumed on behalf of its clients: (1) the investment adviser and its clients have agreed in advance to limit the conditions under which the investment adviser would exercise voting authority; or (2) the investment adviser has determined that refraining is in the best interest of the client, which could be the case where the investment adviser determines that the cost to the client of voting the proxy exceeds the expected benefit to the client. However, the investment adviser may not ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies and cannot fulfill its fiduciary responsibilities to its clients by merely refraining from voting the proxies.

The guidance encourages investment advisers and proxy advisory firms to review their existing policies and practices in advance of the 2020 annual meeting and proxy season.

For a more in-depth analysis, refer to the upcoming issue of Skadden's *Investment Management Update*. Additional information is available in the [SEC's Guidance Regarding Proxy Voting Responsibilities of Investment Advisers](#).

Applicability of the Federal Proxy Rules to Proxy Voting Advice

The release relating to proxy voting advice reiterates prior SEC statements and reinforces the view that proxy voting advice generally constitutes a "solicitation" within the meaning of Exchange Act Rule 14a-1. The SEC has determined that this voting advice represents "communication[s] to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." This interpretation does not affect proxy advisory firms' ability to rely on exemptions from the information and filing requirements of the federal proxy rules, but it does make clear that proxy voting advice is subject to the anti-fraud provisions of the proxy rules. Specifically, Exchange Act Rule 14a-9 prohibits a solicitation from containing any statement that is false or misleading with respect to any material fact or omitting to state any material fact necessary in order to make the statements therein not false or misleading.

The guidance recommends that proxy advisors consider whether additional disclosures should be included in proxy voting recommendations to avoid potential liability under Rule 14a-9, such as disclosing the methodology used to formulate their voting advice on a particular matter (including any material deviations from publicly announced guidelines or policies), any material differences between information derived from third-party sources and public disclosures provided by companies, and appropriate information regarding any material conflicts of interest so that the relevance of the conflicts can be assessed by the user of the recommendation.

Additional information is available in the SEC's [Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice](#).

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As mentioned above, we do not anticipate that actions taken by investment advisers or proxy advisory firms in response to the guidance will significantly impact companies' plans or timelines in connection with the 2020 annual meeting and proxy season.

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