

SEC Warns Advisers to Up Their Game on Proxy Voting

September 10, 2019

KEY POINTS

- Advisers using proxy advisory firms must conduct due diligence when the firm is hired.
- Advisers must annually review and document the performance of the proxy advisory firm.
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On August 21, a sharply divided Securities and Exchange Commission (SEC) issued two interpretive releases addressing the proxy voting obligations of investment advisers and the obligations of proxy advisory firms.¹

The split among the Commissioners had procedural implications that followed from whether the releases changed existing law — a point on which the Commissioners could not even agree. Two Commissioners argued that the law had been changed, which meant that the Administrative Procedures Act (APA) requirements should have been followed. The APA requires that notice is given and comments are solicited from the public and that a cost-benefit analysis is provided, neither of which were done. The three Commissioners in the majority argued that the releases stated nothing new.

What this means for investment advisers and proxy firms

The releases certainly impose greater burdens on both proxy advisers and on investment advisers that use proxy advisory services. Advisers that use proxy advisory firms must conduct 1) due diligence on the proxy advisory firms when they are hired; and 2) that the performance of these firms be reviewed annually. The advisory firm's policies and procedures must require these reviews and the reviews themselves must be documented. The proxy advisory firms themselves are, for the first time, labeled in writing by the SEC as proxy solicitors, which exposes them to potential anti-fraud liability under the proxy rules.

Even advisers that do not use proxy advisory firms must up their game. Advisory firms must conduct and document annual reviews of their proxy voting activities. Advisory firms must consider tailoring proxy guidelines to each individual client account. A decision not to vote proxies must be based on a documented cost-benefit analysis. The releases also seem to call for detailed issuer-specific analysis by advisers in some cases. Advisers may need to identify the factors they will consider in determining whether to conduct an issuer-specific or matter-specific analysis.

The releases make clear that advisers may agree with their clients that the client, and not the adviser, will vote proxies. For some accounts, such as registered investment companies, this may be impractical since no one other than the adviser will be prepared to vote proxies.

¹ Adviser Act Rel. 5325, available [here](#); Exchange Act Rel. 86721, available [here](#).

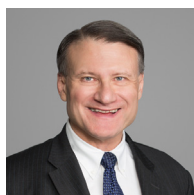
In the view of the Investment Advisers Association, “this guidance will impose significant additional burdens on advisers in connection with proxy voting. We also believe that the guidance will make it more challenging for advisers to use the services of proxy advisory firms.”

Conclusion

According to the releases, advisers are “encourage[d] . . . to review their policies and procedures in light of the guidance in advance of next year’s proxy season.” Investment advisers and proxy advisory firms should consider working with legal counsel to ensure compliance.

CONTACTS

For more information, please contact any of the following members of Katten’s [Financial Markets and Funds](#) practice.



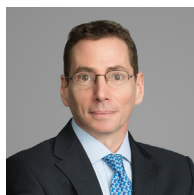
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