

SEC Issues Regulatory Guidance on Proxy Voting Responsibilities and Proxy Advisory Firms

On June 30, 2014, the Staff of the Securities and Exchange Commission's Divisions of Investment Management and Corporation Finance issued regulatory [guidance](#) regarding the responsibilities of registered investment advisers or investment advisers required to be registered with the Commission (collectively, "RIAs") in voting client proxies and retaining proxy advisory firms, and on exemptions to the federal proxy rules that are often relied upon by proxy advisory firms.

Proxy advisory firms, like Institutional Shareholder Services and Glass Lewis, hired by institutional investors to recommend how to vote proxy votes on their behalf, have come under increasing criticism about their outsized influence in key corporate elections (board, executive pay and other governance matters), undisclosed potential conflicts of interest and lack of transparency and accountability, at a time when corporate elections have grown more competitive amid a rise in activist investing. The Staff expects investment advisers and proxy advisory firms to make changes to their current systems and processes in light of this guidance promptly, but in any event in advance of the next calendar year's proxy season.

Investment advisers proxy voting responsibilities

The guidance clarifies that an RIA is not required to vote every proxy on its client's behalf and that an RIA and its client have flexibility in determining the scope of the RIA's obligation to exercise proxy voting authority. To illustrate this flexibility, the guidance lists as examples the following arrangements:

- An RIA and its client may agree that the time and costs associated with the mechanics of voting proxies with respect to certain types of proposals or issuers may not be in the client's best interest.
- An RIA and its client may agree that the RIA should exercise voting authority as recommended by management of the company or in favor of all proposals made

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by a particular shareholder proponent, as applicable, absent a contrary instruction from the client or a determination by the RIA that a particular proposal should be voted in a different way if, for example, it would further the investment strategy being pursued by the RIA on behalf of the client.

- An RIA and its client may agree that the RIA will abstain from voting any proxies at all, regardless of whether the client undertakes to vote the proxies itself.
- An RIA and its client may agree that the RIA will focus resources on only particular types of proposals based on the client's preferences.

The guidance confirms that as a fiduciary and in order to satisfy its duties to its clients, an RIA must implement policies and procedures designed to provide active and ongoing oversight of any proxy adviser to ensure that proxies are voted in the best interests of its clients. In particular, an investment adviser must monitor a proxy adviser's capacity and competency to provide proxy voting advice based on current and accurate information. If an RIA finds that a proxy advisory firm's recommendation was based on a material factual error that causes the adviser to question the process by which the proxy advisory firm develops its recommendations, the RIA should take reasonable steps to investigate the error, taking into account, among other things, the nature of the error and the related recommendation, and seek to determine whether the proxy advisory firm is taking reasonable steps to seek to reduce similar errors in the future. The guidance further clarifies that an RIA must review at least annually whether such policies are adequate and have been implemented effectively.

Proxy advisory firms

The Staff confirms that the furnishing of proxy advice by the proxy adviser constitutes a solicitation subject to the federal proxy rules. Notably, proxy advisers are subject to the antifraud rules set forth in Rule 14a-9 for false or misleading statements involving material facts or omissions.

The guidance imposes an affirmative duty on proxy advisers to disclose to their clients any material interest or relationship in the matter that is subject of the voting recommendation, such as providing consulting services to a company on a matter that is subject of a voting recommendation or providing a voting recommendation on a proposal sponsored by another client. Boilerplate language will not constitute sufficient disclosure. The nature and scope of the interest or relationship, any steps taken to mitigate the conflict and any other information to allow the client to assess the objectivity of the proxy adviser's recommendation must be disclosed to clients. The rules, however, do not require that such disclosures be made public.

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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