July 29, 2020

SEC Supplements Guidance to Investment Advisers About Proxy Voting Responsibilities in View of Proxy Rule Amendments

On July 22, 2019, the SEC adopted amendments to the proxy rules under the Exchange Act (the "Amendments") affecting firms that provide proxy voting advice (a "Proxy Adviser"). The Amendments are described in a separate Ropes & Gray Alert.

At the same meeting at which it approved the Amendments, the SEC also issued a supplement (the "Supplement") to its earlier interpretive guidance, *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, which was published in August 2019 (the "IA Release," and described in this Ropes & Gray Alert). The Supplement, like the Amendments, was adopted in a 3-1 vote, with Democratic Commissioner Lee dissenting.

- To avail themselves of a safe harbor exempting Proxy Advisers from the information and filing requirements of the proxy rules, the Amendments will require each Proxy Adviser (i) to make its voting advice available to issuers at no charge before or at the time that the Proxy Adviser provides the voting advice to its clients and (ii) to provide its clients with a means to access an issuer's EDGAR-filed written response, if any, to the Proxy Adviser's voting advice in a timely manner. These new requirements, according to the Supplement, "will result in improvements in the mix of information that is available to investors and material to a voting decision."

- The Supplement states that its guidance is intended to assist investment advisers use the additional information that may result from the Amendments, especially in situations where an investment adviser relies on a Proxy Adviser's electronic vote management system that "pre-populates" the investment adviser's proxies with voting recommendations and/or relies on a Proxy Adviser for automated proxy voting services. The Supplement also describes an investment adviser's disclosure obligations arising from its use of these services.

The Supplement, which will become effective upon its publication in the *Federal Register*, is summarized below.

The IA Release and the Supplement

The IA Release contained the SEC's guidance regarding investment advisers' proxy voting responsibilities under fiduciary principles and Rule 206(4)-6 under the Advisers Act. In particular, much of the IA Release was devoted to providing guidance to investment advisers that rely on the assistance of a Proxy Adviser to fulfill some part of their proxy voting responsibilities. The IA Release's guidance provided detailed examples of matters that an investment adviser "should consider" when relying on a Proxy Adviser and followed a Q&A format with six questions. The SEC followed that format in the Supplement by adding a new Question 2.1:

> Question 2.1. In some cases, proxy advisory firms assist clients, including investment advisers, with voting execution, including through an electronic vote management system that allows the proxy advisory firm to: (1) populate each client's votes shown on the proxy advisory firm's electronic voting platform with the proxy advisory firm's recommendations based on that client's voting instructions to the firm ("pre-population"); and/or (2) automatically submit the client's votes to be counted ("automated voting"). Pre-population and automated voting generally occur prior to the submission deadline for proxies to be voted at the shareholder meeting. In various circumstances, an investment adviser, in the course of conducting a reasonable investigation into matters on which it votes, may become aware that an issuer that is the subject of a voting recommendation intends to file or has filed additional soliciting materials with the Commission setting forth the issuer's views regarding the voting recommendation. These materials may or may not reasonably be expected to affect the investment adviser's voting determination. In addition, these materials may become available after or around the same time

> that the investment adviser's votes have been pre-populated but before the submission deadline for proxies to be voted at the shareholder meeting. In these circumstances, what steps should an investment adviser take to demonstrate that it is making voting determinations in a client's best interest?

The SEC response to Question 2.1 notes that, in the IA Release, the SEC discussed steps an investment adviser should consider when it utilizes a Proxy Adviser, including assessing pre-populated votes shown on the Proxy Adviser's electronic voting platform. The response then states that an investment adviser should consider whether its policies and procedures, including any on automated voting of proxies, are reasonably designed to ensure that it exercises voting authority in its client's best interest.

> ***Note**: While the response repeats that an investment adviser is obligated to exercise its voting authority in its client's best interest, it may not be in the client's best interest for the adviser to make such a determination on every proposal, notwithstanding additional material from an issuer. Indeed, the prohibitive cost of undertaking a pre-vote determination with respect to every proposal is why many advisers choose to rely, in whole or in part, on the recommendations of a Proxy Adviser.*

In particular, the SEC response states that an investment adviser should consider whether its policies and procedures cover instances where the investment adviser becomes aware that an issuer intends to file or has filed additional soliciting materials with the SEC after the investment adviser has received its Proxy Adviser's voting advice but before the proxy submission deadline. Moreover, according to the response, if an issuer files additional information "sufficiently in advance of the [proxy] submission deadline and the additional information "would reasonably be expected to affect the investment adviser's voting determination," an investment adviser would need to consider such information before submitting a proxy to demonstrate that it is voting in its client's best interest.

> ***Note**: To comply with the Amendments' safe harbor conditions, each Proxy Adviser will create a means of communicating with its clients that an issuer intends to file or has filed additional materials with the SEC. The added costs of these communications and investment advisers' costs of taking a "second look" at an issuer's proposal will be passed on to investors. Nonetheless, the SEC response suggests that investment advisers that ignore issuers' additional information do so at their peril, without regard to the expected costs and benefits of taking a second look before submitting a proxy. In this vein, Commissioner Lee, in her statement accompanying her dissenting vote, observed: "The uncharacteristically prescriptive requirement for advisers to wait for and review the views of a particular party threatens to add significant complexity, delay, and costs to an already complicated undertaking. Those costs will be borne by advisers directly and by their clients indirectly."*

The SEC response also covers an investment adviser's obligation, arising from its duty of loyalty to clients, to make full and fair disclosure to its clients of all material facts relating to the advisory relationship. Rule 206(4)-6 under the Advisers Act and Form ADV separately require an investment adviser to describe to clients its voting policies and procedures. Accordingly, the response states that an investment adviser that uses automated voting should consider disclosing (i) the degree of that practice and under what circumstances it uses automated voting and (ii) how its policies and procedures address the use of automated voting when it learns, before a proxy submission deadline, that an issuer intends to file or has filed additional soliciting materials with the SEC about a matter to be voted upon.

Regarding the sufficiency of this disclosure, the response states that, in some instances, automated voting disclosures must be sufficiently specific so that a client can comprehend the investment adviser's use of automated voting. Otherwise, a client may not have enough information to provide informed consent to the use of automated voting. The response states that an investment adviser should carefully review its automated voting disclosures to assure that it provides its clients with sufficient information to make informed consent to the use of automated voting and for the investment adviser to fulfill its obligations under Rule 206(4)-6 and Form ADV.

Additional Observations

The Amendments require a Proxy Adviser to provide its clients with a mechanism by which they can be reasonably expected to become aware of any written statements by companies about the Proxy Adviser's voting advice. That requirement is satisfied under the safe harbor if the Proxy Adviser informs its clients when a company notifies it that the company "intends to file or has filed additional soliciting materials. . . ." The Proxy Adviser would provide such notice on its electronic platform or by email, including an active hyperlink to those materials on EDGAR when available.

The Supplement does not address issues that exist under the IA Release's guidance to investment advisers regarding their proxy voting responsibilities (many of which were discussed in Ropes & Gray's Alert on the IA Release). Among these issues is the fact that interpretive guidance from the SEC has a way of becoming a baseline for compliance.

Since the IA Release's publication in the *Federal Register* in September 2019, a proxy season has passed without news of investment advisers failing to satisfy the requirements of the IA Release. Of course, it is impossible to describe the 2020 proxy season as "typical" due to COVID-19 concerns and, even under normal circumstances, it is difficult to predict SEC enforcement actions with respect to a new rule or interpretive release within its first year. The SEC's Office of Compliance Examinations and Inspections' (January) 2020 Examination Priorities did *not* indicate that investment adviser proxy voting was among its priorities.

Nonetheless, the IA Release and the Supplement make it abundantly clear that, if an investment adviser relies on a Proxy Adviser, it is obligated to conduct robust diligence and oversight to ensure that the Proxy Adviser produces advice that is in the best interest of the adviser's clients. In addition, as the Supplement makes clear, these investment advisers also must be ready to review additional information timely submitted by an issuer. If material, investment advisers that in whole or in part rely on a Proxy Adviser for automated voting also may separately consider reviewing their disclosures regarding automated voting.

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For further information about how the issues described in this Alert may impact your interests, please contact your regular Ropes & Gray attorney.