

# ClientAlert

## Capital Markets

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### SEC Issues Guidance on Proxy Voting Relevant to Proxy Advisers and Investment Advisers: Any Significant Impact on the Current Proxy Voting System Is Unlikely

Growing concerns regarding the increasingly prominent role of proxy advisory firms, including Institutional Shareholder Services and Glass Lewis, were largely not addressed when, on June 30, 2014, the Securities and Exchange Commission's (the "SEC") Division of Investment Management and Division of Corporation Finance issued joint guidance—Staff Legal Bulletin No. 20, "Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms" ("SLB No. 20"). Investment advisers routinely rely on proxy advisory firms' voting recommendations for proposals presented for shareholder vote and on general recommendations regarding corporate voting matters, such as director elections and executive compensation. Many public companies take proxy advisory firms' recommendations very seriously because such recommendations are able to have a meaningful impact on corporate voting results. While SLB No. 20 addressed some of these concerns, including with respect to potential conflicts of interest, proxy advisory firms are likely to retain a significant influence on the outcomes of corporate voting matters as investment advisers are expected to continue to rely on voting recommendations in making decisions on behalf of shareholders of their portfolio companies.

Composed of 13 Q&As, SLB No. 20 outlines the Division of Investment Management clarifications about investment advisers' responsibilities in voting client proxies and retaining proxy advisory firms (Q&As 1–5) and the Division of Corporation Finance clarifications regarding the availability and requirements of two exemptions to the federal proxy rules that are often relied upon by proxy advisory firms (Q&As 6–13). As a practical matter, SLB No. 20 focuses on conflicts of interest and excessive reliance on voting recommendations of proxy advisory firms. Following SLB No. 20, proxy advisory firms are required to disclose to their clients any conflicts of interest if, for instance, a proxy advisory firm provides consulting services to a company on a matter central to a voting recommendation. Investment advisers are now required to adopt, implement and periodically evaluate proxy voting policies and procedures to ensure that, in following any voting recommendations, they are acting in their clients' best interests.



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## Guidance for Investment Advisers

The Division of Investment Management reiterated that investment managers that rely on proxy advisers to assist them in making corporate voting decisions on behalf of their clients should ensure they are acting in their clients' best interests. For example, SLB No. 20 specifies that to demonstrate that proxy votes are cast in accordance with clients' best interests and the adviser's proxy voting procedures, investment managers could periodically sample proxy votes and should review the adequacy of their proxy voting policies at least annually. Further, SLB No. 20 specifically indicates that an investment adviser and its client have flexibility in determining the scope of the investment adviser's obligation to exercise proxy voting authority, including through pre-established voting arrangements and agreements (such as an agreement to exercise voting authority as recommended by management of the company or in favor of all proposals made by a particular shareholder proponent, as applicable, absent a contrary instruction from the client).

## Guidance for Proxy Advisers

The Division of Corporation Finance provided some clarifications with respect to the availability and requirements of two exemptions to the federal proxy rules that are often relied upon by proxy advisory firms. By way of background, a proxy advisory firm would be subject to the federal proxy rules when it engages in a "solicitation." As a general matter, the SEC has stated that the furnishing of proxy voting advice constitutes a "solicitation" subject to the information and filing requirements of the federal proxy rules. Rule 14a-2(b)(1) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") provides an exemption from most provisions of the federal proxy rules for "any solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as a proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization." Rule 14a-2(b)(3) exempts the furnishing of proxy voting advice by any person to another person with whom a business relationship exists, subject to certain conditions.

SLB No. 20 specifies that Rule 14a-2(b)(1) exemption is not available to a proxy advisory firm offering a service that allows the client to establish, in advance of receiving proxy materials for a particular shareholder meeting, general guidelines or policies that the proxy advisory firm will apply to vote on behalf of the client. In this instance, the proxy advisory firm would be viewed as having solicited the "power to act as a proxy" for its client. This would be the case even if the authority was revocable by the client. However, if a proxy advisory firm only distributes reports containing recommendations and does not solicit the power to act as proxy for the client(s) receiving the recommendations, the proxy advisory firm would be able to rely on the exemption, so long as the other requirements of the exemption are met. To the extent that Rule 14a-2(b)(1) is not available to a proxy advisory firm, it may be able to assess the availability of Rule 14a-2(b)(3) exemption by analyzing whether its relationship with the company or security holder proponent is significant or whether it otherwise has any material interest in the matter that is the subject of the voting recommendation. The exemption, which applies to the furnishing of proxy voting advice by any person to another person with whom a business relationship exists, is available if the person gives financial advice in the ordinary course of business; discloses to the recipient of the advice any significant relationship with the company or any of its affiliates, or a security holder proponent of the matter on which advice is given, as well as any material interests of the person in such matter; receives no special commission or remuneration for furnishing the advice from any person other than the recipient of the advice and others who receive similar advice; and does not furnish the advice on behalf of any person soliciting proxies or on behalf of a participant in a contested election. In this instance, the proxy advisory firm is required to provide meaningful disclosure to the recipient of the voting recommendation of any relationship or material interest to enable the recipient to understand the nature and scope of the relationship or interest, including the steps taken, if any, to mitigate the conflict. If, for instance, a proxy firm provides consulting services to a company on a matter central to a voting recommendation, it must be disclosed if it is deemed a "material" interest. This disclosure may be made publicly or privately between only the proxy advisory firm and the client. The SEC indicates that the exemption imposes an affirmative duty to disclose, and the obligation is not satisfied if the information is provided upon request.

## Conclusion

SLB No. 20 provides important clarifications with respect to the requirements applicable to investment managers in connection with representing their clients' interests in corporate voting matters and to proxy advisers, including in connection with disclosure of conflicts of interest. However, while SLB No. 20 imposes additional disclosure obligations on proxy advisory firms and specific monitoring obligations on investment advisers in an attempt to address concerns relating to the perceived conflicts of interest, SLB No. 20 may disappoint some companies that expected the SEC to take a stronger position in response to the growing concerns over the increasing influence of the proxy advisory firms in the corporate voting process. The complete text of SLB No. 20 is available [here](#).

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