

# M O R R O W S O D A L I

MARCH 2019  
PROXY UPDATE

## SEC COMMENTS ON PROXY PROCESS

SEC COMMISSIONER SEEKS FEEDBACK ON PROXY VOTING, PROXY ADVISORS,  
PROXY “PLUMBING” AND SHAREHOLDER PROPOSALS

Last week, Commissioner Elad L. Roisman made a [speech](#) at the ICI Mutual Funds and Investment Management Conference about the proxy process. In the speech, the Commissioner asked many questions and requested feedback from investors on several topics including proxy voting by institutional investors, the role of proxy advisors, proxy plumbing and shareholder proposals.

The Commissioner stated in his speech that his experience at a law firm and as an in-house counsel at an exchange, as well as at the SEC and in Congress “...led me to take great interest in the proxy process and recognize its fundamental importance to our capital markets.”

### Proxy Voting

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Regarding voting of proxies by institutional advisers, the Commissioner asked: “What is in the best interest of a fund in the context of proxy voting?” And he also stated that “... when advisers vote proxies for the funds they manage, they must do so in a way that serves the best interests of each fund.” The Commissioner also noted that the Commission has acknowledged that voting proxies has associated costs – both from a time and dollar perspective.

This has led the Commissioner to question the default position of many advisers to vote every proxy for every company. The Commissioner believes that the answer to the question “Is an investment adviser required to vote every proxy?” is, in some cases, “NO”.

The Commissioner asks for adviser’s perspectives on considerations regarding which company proxies advisers should vote - such as whether the outcome of the vote is material to the fund, whether a company is a material part of the fund’s portfolio, what the opportunity cost is to the fund voting a particular proxy and whether the potential benefits justify the cost.

The Commissioner also questions and is seeking to better understand whether centralized voting functions (where voting is moved farther away from portfolio managers) align with the best interests of individual funds; noting that individual funds in the same fund complex may have different investment objectives and time horizons.

He points to an example of a merger proposal that would benefit the shares of the target held by one fund but hurt the acquirer's shares held within another fund in the same fund complex. He asks how advisers handle these types of conflicts and whether advisers with centralized voting remained cognizant of distinctions between funds.

## Proxy Advisory Firms

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The Commissioner also had many questions regarding the use of proxy advisory firms. The Commissioner's questions and comments add to the pressure on the proxy advisors that has been brought to bear by the U.S. Chamber of Commerce, the National Association of Manufacturers, Nasdaq, the Society of Governance Professionals and others. In particular, the Commissioner questions advisers that adopt the proxy advisory voting guidelines as their own, automatic voting of adviser's shares by the advisory firms, the accuracy of proxy advisory reports, conflicts of interest and whether the Commission should provide additional guidance on the use of proxy advisors by asset managers.

The Commissioner states that the SEC should not impose additional regulation on proxy advisory firms without "thorough consideration."

The Commissioner questions how asset managers come to understand what they are signing on to when adopting proxy advisory voting guidelines as their own. In his review of Form ADVs, the Commissioner said he noticed several things that would give him pause before adopting them, including whether the guidelines appear to undermine existing legal rights. The Commissioner is wondering to what extent advisers are customizing guidelines to best serve their clients.

The Commissioner is also looking for feedback directly from asset managers on how they are using proxy advisory firms to cast votes and questions whether asset managers may be relying too heavily on proxy advisory firms; resulting in "robo-voting".

The Commissioner also raises concerns about the potential for factual errors in the proxy advisory reports that could affect voting and the fact that most issuers do not get advanced copies of the reports. He asks how asset managers reassess the way they are using proxy advisory firms when there is a material error in the proxy advisory firm's recommendation or underlying research. He is also interested in hearing how advisers receive input from issuers before voting and whether the Commission should explore ways to make it easier for advisers to get this information in a timely manner.

The Commissioner also addresses potential conflicts of interest at the proxy advisory firms, especially at firms that provide voting recommendations as well as consulting for corporate clients. He questions whether proxy advisory firms that provide corporate consulting services would recommend against their own consulting services. The Commissioner is also looking for feedback as to how asset managers assess potential conflicts at the advisory firms, and how they can get comfortable with the proxy advisory firm's methodologies for dealing with conflicts. He further asks if information about potential conflicts could be presented better and what asset managers are doing on an ongoing basis to monitor conflicts.

The Commissioner states that the asset managers, as primary users of the proxy advisory firms, are in the best position to provide input on his questions and whether industry demand could produce better results from the proxy advisory firms or whether the Commission should consider other ways.

Finally, with regard to the proxy advisory services, the Commissioner believes it is a good time for the Commission to consider whether SEC guidance would help asset managers as they determine how to use the services of the proxy advisory firms and whether it is appropriate to reassess if the current practices of the proxy advisory firms fit within the intended scope and purpose of the exemption from the proxy solicitation rules.

## Proxy Plumbing

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The Commissioner is also interested in feedback on proxy-related reforms around proxy “plumbing” and shareholder proposals. Noting that the November roundtable “...shed light on how complex, inefficient, and, at times, unreliable this infrastructure is”, the Commissioner believes the Commission needs to consider both quick fixes and comprehensive solutions based on modern technology. This would include a way to achieve end-to-end vote confirmation. He is also interested in hearing what can be accomplished through private ordering versus action by the Commission.

## Shareholder Proposals

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Regarding shareholder proposals, the Commissioner is interested in looking at thresholds for submission and resubmission of shareholder proposals. He is looking to balance the need for “robust shareholder engagement” with a system that currently provides certain shareholders who have “idiosyncratic views” a platform that does not benefit the interests of long-term shareholders. He asks if the current monetary and holding thresholds are appropriate and if the resubmission thresholds should be raised to preserve management time and shareholder money from being spent on the same proposals repeatedly even though they have been rejected by the majority of shareholders.

Finally, the Commissioner is looking to understand how allowing “proposal by proxy” is in the long-term interest of shareholders when the proponent is either not a shareholder or cannot qualify to bring the proposal on his or her own.

The Commissioner concluded his remarks by saying he is looking forward to engaging further with shareholders and that his “door is open.”

We will continue to follow these developments and provide feedback and guidance to clients on how changes to the proxy process will impact proxy solicitations and interactions with all stakeholders.