

# Use of Proxy Advisory Firms in the Fund Industry: Evaluating and Implementing SEC Staff Guidance

Investment Company Institute Webinar

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# Panel

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- Matthew Thornton, Moderator  
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Investment Company Institute
- Paul Beste  
Chief Operating Officer  
Heartland Advisors, Inc.
- Michelle Edkins  
Managing Director, Global Head of Corporate Governance and Responsible Investment  
BlackRock
- Michael Mabry  
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# Recent Developments

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- SEC Staff Legal Bulletin No. 20
- 2015 OCIE Exam Priority – “Proxy Services”

# SEC and Staff Pronouncements on Proxy Advisory Firms (pre-2014 Bulletin)

- 2003 SEC rules, form amendments, and adopting releases are limited in addressing the role played by proxy advisory firms in proxy voting.
- SEC staff's 2004 no-action letters (*Egan-Jones Proxy Services* and *Institutional Shareholder Services, Inc.*) address conflict of interest scenarios.
- SEC's 2010 *Concept Release on the U.S. Proxy System* included a discussion of (i) the role and legal status of proxy advisory firms, (ii) concerns about their role, and (iii) potential regulatory responses.

# SEC Staff Legal Bulletin No. 20

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The June 2014 SEC staff bulletin provides guidance about:

- investment advisers' proxy voting responsibilities, particularly with respect to their use of proxy advisory firms
- the exemptions to the federal proxy rules that are commonly relied upon by proxy advisory firms

# SEC Staff Legal Bulletin No. 20 – Key Takeaways

Key takeaways from the portion of the Bulletin directed to investment advisers:

- Fiduciaries with respect to services undertaken
- Together with clients, have flexibility regarding proxy voting arrangements
- Should ascertain the proxy advisory firm’s “capacity and competency to adequately analyze proxy issues”
- Must provide ongoing oversight of the proxy advisory firm
- Should take reasonable steps to investigate material errors and seek to determine whether the proxy advisory firm is taking reasonable steps to seek to reduce similar errors in the future

# Initial Due Diligence of Proxy Advisory Firms – Fund Advisers

## Key considerations:

- Capacity and competency of proxy advisory firm
- Approach taken can be broadly similar to that taken for other fund service providers
- Anticipated costs and benefits of (i) hiring proxy advisory firm, and (ii) alternatives
- Nature and quality of services to be provided, quality and experience of the personnel, stability of the organization, competitiveness of pricing, and any potential conflicts of interest

# Initial Due Diligence of Proxy Advisory Firms – Fund Boards

## Key considerations:

- May choose to be involved to varying degrees in the selection and approval of proxy advisory firms
- Could determine to approve a proxy advisory firm based on the fund adviser's recommendation, or could delegate the selection of the proxy advisory firm to the fund adviser, subject to the board's oversight



# Ongoing Oversight of Proxy Advisory Firms – Fund Advisers

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- Reviews conducted at least annually
- A function of the nature and extent of the services the proxy advisory firm provides
- Could address the proxy advisory firm's actual performance since the last review

# Ongoing Oversight of Proxy Advisory Firms – Fund Boards

- Board generally will rely on the fund adviser to report on the firm's performance; the fund's CCO may report on compliance-related matters.
- Board and fund adviser generally will determine the frequency of board reports and their content.
- Reporting depends on the level and types of proxy advisory firm services used.

# Use of Proxy Voting Guidelines

- Subject to board approval, fund advisers may formulate and maintain proxy voting guidelines, and may receive input from proxy advisory firms.
- A fund adviser receiving input from a proxy advisory firm may wish to consider: the firm's standard proxy voting guidelines and how they are formulated and revised.
- The fund adviser and the fund board should review the proxy voting guidelines at least annually.

# Proxy Advisory Firms' Research and Recommendations

- Initial review (and subsequent reviews, as appropriate): consider assessing the resources that a proxy advisory firm dedicates to proxy research and analysis.
- To understand the analytical process, could inquire about:
  - Extent to which the firm's standard guidelines determine ultimate recommendations
  - Information relied upon and parties typically consulted
  - Methodologies and models that influence the firm's recommendations

# Proxy Advisory Firms' Potential Conflicts of Interest

- Consider whether the proxy advisory firm can make recommendations that are in the best interest of the fund.
- Should have an understanding of a proxy advisory firm's:
  - organizational structure and business relationships, and whether they could give rise to any potential conflicts; and
  - processes for identifying, mitigating, and disclosing its potential conflicts
- Could make a determination regarding a proxy advisory firm's impartiality by conducting a thorough review of the firm's conflict procedures and the effectiveness of their implementation

# Review of and Response to Errors

- Can be categorized as (i) operational errors (e.g., neglecting to submit voting instructions on behalf of a fund), or (ii) errors related to research or analysis (e.g., making an error in a research report)
- When a fund adviser learns of a material error, it should investigate the error and seek to determine whether the proxy advisory firm is taking reasonable steps to seek to reduce similar errors in the future.
- As with any service provider, could consider the types of errors that it could encounter and then review the design of the proxy advisory firm's policies, procedures, and controls.

**Questions?**

# Panel Biographies

- Matthew Thornton is Counsel for the Investment Company Institute, with responsibility for a wide range of legal issues affecting registered investment companies. Mr. Thornton's primary areas of responsibility include advertising/social media, fixed income-related issues, proxy voting, anti-money laundering, target date funds, disclosure, and investment advisory matters. Prior to joining the Institute in 2014, he was an Associate in Dechert LLP's Financial Services Group from 2005 to 2014. Prior to practicing law, Mr. Thornton held positions in the financial services industry at SunTrust Banks (1998 to 2005) and Merrill Lynch (1997 to 1998). Mr. Thornton is a member of the Maryland and District of Columbia bars and a Certified Financial Planner™. He is a graduate of the University of Notre Dame (BA, Economics) and Georgetown University Law Center (JD).
- Paul Beste, CPA, is Chief Operating Officer, Director, and Secretary of Heartland Advisors, Inc. He also is Vice President and Assistant Secretary of the Heartland Funds. He joined Heartland in 1997. Over the last 16 years at Heartland, Paul has been involved with all aspects of the business, including strategic planning, selection of key business partners, implementation of conversions, and change and process management. He has been quoted as an authority on a variety of business topics in the Wall Street Journal and in local publications. Paul is one of Heartland's Managing Partners and a member of the Firm's Investment Policy Committee. He has previously served on a number of other committees throughout his career at Heartland. From 1992 to 1997, Paul served as Director of Tax at Strong Capital Management. From 1984 through 1992, he worked at Pricewaterhouse Coopers as a Tax Manager. Paul received his B.B.A. in Accounting and his M.S.T. in Taxation from the University of Wisconsin–Milwaukee, and his M.B.A. in Business from Marquette University. He is also a Certified Public Accountant.



# Panel Biographies

- Michelle Edkins is a Managing Director at BlackRock and Global Head of its Corporate Governance and Responsible Investment team of 20 specialists based in five key regions internationally. Michelle is responsible for the team's engagement and proxy voting activities in relation to the companies in which BlackRock invests on behalf of clients. She also serves on the firm's Human Capital and Government Relations Steering Committees. An active participant in the public corporate governance debate, she was named in the NACD Directorship 100 Governance Professionals list the past three years. She is also a Fellow of the Aspen Institute's First Movers program and a former Chairman of the Board of Governors of the International Corporate Governance Network. She currently serves on the Advisory Councils of the Sustainability Accounting Standards Board and the International Integrated Reporting Council, and is a member of the steering group of the US chapter of the 30% Club, a market initiative to increase the number of women on boards and in senior management. An economist by training, Michelle has also worked in the UK in a number of governance-related roles and in government roles in her native New Zealand.
- Michael D. Mabry is a partner in the Philadelphia office of Stradley Ronon Stevens & Young. Mr. Mabry regularly counsels investment companies, investment advisers and other financial service providers on a variety of securities and corporate matters involving mutual funds, closed end funds, ETFs, UITs, variable insurance products, offshore and private funds, and adviser separate accounts. He has counseled boards of directors and investment advisers on regulatory and litigation matters, including SEC examinations, closed end fund proxy fights, rescissions and class action suits, and has helped establish compliance programs for investment advisers and fund complexes of all sizes. He frequently helps clients develop and launch new and innovative investment products, and handles complex fund transactions such as mergers, leverage facilities, proxy solicitations, ETF launches, and closed end fund IPOs. Mr. Mabry is a 1991 graduate of the University of Virginia School of Law and holds a Master's Degree in Economics from Bowling Green State University. He graduated from the University of Michigan in 1984, and served as a research assistant with the Federal Reserve Board from 1985 to 1988.

# CLE Credit

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