If you have any questions about this Advisory, please contact:

RICHARD LEVAN
215.988.8316
rlevan@wiggin.com

CONOR MULLAN
215.988.8319
cmullan@wiggin.com

SEC To Hold Roundtable On Proxy Voting

The SEC will host a public roundtable on December 5th to discuss the use of proxy advisory firm services by investment advisers, mutual fund and other institutional investors. This meeting, which comes on the heels of several speeches by SEC Commissioner Daniel Gallagher questioning whether investment advisers are overly relying on service providers for proxy voting responsibilities, could mark the first step toward new regulations for the financial services industry.

PROXY VOTING SERVICES

Investment advisers generally have a fiduciary duty to vote proxies in the client's best interests. Additionally, under Rule 206(4)-6 of the Advisers Act, advisers that have proxy voting authority are required, among other things, to adopt proxy voting policies and procedures reasonably designed to ensure that the adviser votes client securities in the client's best interest and addresses how conflicts of interest are handled. To fulfill these legal and compliance obligations, most investment advisers rely on third-party proxy voting vendors for providing voting recommendations that are consistent with the adviser's policies and procedures (or proxy voting guidelines).

However, SEC Commissioner Gallagher has recently expressed concerns that advisers are not fulfilling their fiduciary duties when they routinely follow recommendations from proxy advisory firms. In a July 2013 speech, Gallagher said:

It is troubling to think that institutional investors, particularly investment advisers, are treating their responsibility akin to a compliance function carried out through rote reliance on proxy advisory firm advice rather than actively researching the proposals before them and ensuring that their votes further their clients' interests. The last thing we should want is for investment advisers to adopt a mindset that leads to them blindly casting their votes in line with a proxy advisor's recommendations, especially given the fact that such recommendations are often not tailored to a fund's unique strategy or investment goals.

According to Gallagher, the danger in overly relying on vendors for proxy voting decisions is that the two largest vendors – ISS and Glass Lewis -- wield too much power. In fact, Gallagher noted in a speech last week that ISS and Glass Lewis control close to 97% of the market, and he pointed to studies purportedly demonstrating that their recommendations have an enormous impact on corporate voting outcomes. According to one study, a voting recommendation by ISS on a management proposal can result in more than a 20% sway in the vote.

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SEC To Hold Roundtable On Proxy Voting CONTINUED

UPCOMING ROUNDTABLE

The SEC roundtable, which will be held at the SEC's Washington, D.C. headquarters and will be available on the SEC's website via live webcast, should examine Gallagher's contentions and weigh his and others' proposed solutions. One solution that Gallagher has repeatedly called for is the repeal of two 2007 SEC No-action letters that "effectively blessed the practice of investment advisers rotely voting the recommendations provided by proxy advisors" and replacing them with Commission-level guidance for investment advisers designed to ensure that they are meeting their fiduciary duties. Such a solution could have a dramatic impact on the level of attention that advisers currently devote to the proxy voting process, and significantly increase the costs and manpower required to evaluate proxy voting.

Information about the roundtable is available on the Commission's website, and Gallagher's October speech can be found by clicking here. If you have any questions about proxy voting compliance or Rule 206(4)-6, please do not hesitate to contact us.

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