

November 14, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Roundtable on the Proxy Process (*File No. 4-725*)

Dear Mr. Fields:

The Investment Company Institute¹ commends the Securities and Exchange Commission and its staff for holding a roundtable on proxy issues later this week.² Funds take their proxy voting responsibilities very seriously and share the view of many that important issues have arisen concerning the process. The roundtable is a positive way to move forward this important discussion and begin identifying possible constructive solutions.

In advance of the roundtable, I am writing to share with you several ICI publications related to proxy matters. First is a three-part series of ICI Viewpoints explaining important aspects of the proxy voting landscape, including how it has changed over the last several years. We developed these Viewpoints using data for proxy seasons 2003 through 2017.

- [Funds and Proxy Voting: The Mix of Proposals Matter](#) addresses the types of proxy proposals shareholders submitted during the 2017 proxy season and how those have changed over the years.
- [Funds and Proxy Voting: Who Submits Shareholder Proposals](#) identifies the proponents who submitted shareholder proposals and the differences in the types of issues they raised.

¹ The [Investment Company Institute](#) (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$22.7 trillion in the United States, serving more than 100 million US shareholders, and US\$7.0 trillion in assets in other jurisdictions. ICI carries out its international work through [ICI Global](#), with offices in London, Hong Kong, and Washington, DC.

² SEC Press Release, *SEC Announces Agenda, Panelists for Staff Roundtable on the Proxy Process* (November 8, 2018), available at <https://www.sec.gov/news/press-release/2018-260>.

- [Funds and Proxy Voting: Funds Vote Thoughtfully and Independently](#) examines how funds actually voted on 2017 proxy proposals and how their votes compare with Institutional Shareholder Services (ISS) recommendations. One finding comes through the data clearly: fund advisers do not automatically follow anyone's recommendations.

Also included are a report on funds' use and oversight of proxy advisory firms and an ICI Viewpoints examining the serious drawbacks with a recently-advanced idea—fund shareholders, rather than funds, voting the thousands of portfolio company proxies.

- [Report on Funds' Use of Proxy Advisory Firms](#) examines funds' use and oversight of proxy advisory firms. ICI and the Independent Directors Counsel jointly published this report in 2015, working closely with our members.
- [SEC Should Reject Complex, Costly "Pass-Through" Proxy Voting](#) explains the complexities and costs that would be associated with funds passing through voting decisions to fund shareholders. This idea, put forth by the Main Street Investors Coalition and the National Association of Manufacturers, is misguided and impractical and should go no further.

If you have any questions or would like additional information on these, or any other proxy matters, please contact me at (202) 326-5901, Susan Olson, General Counsel, at (202) 326- 5813, or Dorothy Donohue, Deputy General Counsel – Securities Regulation, at (202) 218-3563.

Sincerely,



Paul Schott Stevens
President and CEO

cc: The Honorable Jay Clayton
The Honorable Kara M. Stein
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

Dalia Blass, Director
Paul Cellupica, Deputy Director and Chief Counsel
Division of Investment Management

William Hinman, Director

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Division of Corporation Finance

Sebastian Gomez-Abero, Counsel
Eric Diamond, Counsel
Office of the Chairman

Attachments

NOVEMBER 5, 2018

Funds and Proxy Voting: The Mix of Proposals Matters

BY MORRIS MITLER, SEAN COLLINS, AND DOROTHY DONOHUE

Proxy voting is in the news and on the minds of policymakers, corporate executives, and investors. The Securities and Exchange Commission (SEC) will focus on a number of issues related to proxy advisory firms, shareholder proposals, and technology and innovation to make the proxy process more efficient at a staff roundtable on November 15. Major corporate issuers—organized as the “Main Street Investors Coalition”—are agitating against the voting practices of institutional investors, including registered funds.

Registered investment companies, including mutual funds, exchange-traded funds (ETFs), and closed-end funds, are deeply interested in these debates. As fiduciaries to their shareholders, funds have a duty to consider proxy issues related to their portfolio stocks and act in the best interests of fund shareholders—a duty that funds embrace. And for more than a decade, funds have been the only investors required to disclose all of their proxy votes. As a result, registered funds’ votes draw enormous attention—even though these funds hold less than one-third of the stock of corporate America.

In 2008 and 2010, ICI Research used those fund disclosures to analyze trends in funds’ proxy voting from 2007 through 2009. Our findings then: funds take proxy voting seriously, cast their votes thoughtfully, and favor proposals that they perceive to enhance the value of portfolio companies for fund shareholders. Each fund votes its shares in the interests of its own shareholders.

Given the renewed interest in proxy voting, we are updating that research with data from 2010 through 2017. This is the first of three *ICI Viewpoints* posts presenting preliminary results of that work. In this piece, we’ll show how the proxy voting landscape has changed over the past 15 years.

But first, we should explain how funds discharge their proxy voting responsibilities.

A Primer on Proxies

Like other shareholders, funds are entitled to vote on proxy proposals put forth by a company’s board or by its shareholders. Proposals offered by the board are usually referred to as “management proposals.”

As part of their fiduciary duty to fund shareholders, a fund’s board of directors is responsible for proxy voting. A fund’s board typically delegates proxy voting responsibilities to the fund’s investment adviser, in recognition that proxy voting is part of the investment management process. A fund adviser must have policies reasonably designed to ensure that it votes proxies in the best interests of the fund and its shareholders. Those policies must address material conflicts that may arise between the interests of the fund and those of the adviser in casting proxy votes.

NOVEMBER 6, 2018

Funds and Proxy Voting: Who Submits Shareholder Proposals?

BY MORRIS MITLER, SEAN COLLINS, AND DOROTHY DONOHUE

Any registered fund that holds companies' stocks in its portfolio has a duty to consider proxy proposals offered by those companies—and to act in the best interests of the fund and its shareholders. These funds also have a regulatory obligation to report those votes. As the only investors required to disclose their votes publicly, funds draw an outsized share of the attention focused on proxy issues and voting outcomes. And critics frequently focus on whether they agree or disagree with funds' votes—without regard to funds' obligation to vote in the interests of fund shareholders.

In ICI's 2010 analysis of funds' proxy voting between 2007 and 2009, we showed that a small number of activist individuals and organizations sponsor a large share of the proposals offered by shareholders that make it onto proxy ballots. That concentration raises the question of how closely shareholder proposals reflect the interests of shareholders generally, and fund shareholders in particular.

Our latest research shows the same phenomenon at work during proxy season 2017. Just 10 sponsors submitted 44 percent of the shareholder proposals on proxy ballots. By comparison, the percentage of shareholder proposals submitted by the 10 most frequent sponsors between 2007 and 2009 was nearly 50 percent.

Under Securities and Exchange Commission (SEC) rules, a shareholder who has continuously held either \$2,000 in market value or 1 percent of a company's stock during the previous 12 months is permitted to submit a proxy proposal for consideration at the company's annual meeting. As Figure 1 shows, a relatively small number of proponents submit an outsized share of shareholder proposals.

FIGURE 1

Proponents of Shareholder Proposals Submitted During Proxy Season 2017

	Number of proposals sponsored	Percentage of all proposals	Cumulative number of proposals	Cumulative percentage of proposals
John Chevedden and affiliates ¹	88	16.4	88	16.4
James McRitchie and Myra Young	36	6.7	124	23.1
As You Sow Foundation	18	3.4	142	26.4
Comptroller of the City of New York	16	3.0	158	29.4
New York State Common Retirement Fund	15	2.8	173	32.2
Holy Land Principles, Inc.	14	2.6	187	34.8
AFL-CIO	12	2.2	199	37.1
Arjuna Capital	12	2.2	211	39.3
California State Teachers' Retirement System	12	2.2	223	41.5
New York State Comptroller	11	2.0	234	43.6
130 other sponsors ²	2.3	56.4	537	100.0

¹ This category includes proposals sponsored by John Chevedden, Kenneth Steiner, and William Steiner, whose proposals are often submitted by John Chevedden on their behalf.

² For 130 other sponsors, the number of proposals is the average number of proposals per proponent.

Note: This figure is based on shareholder proposals at the 3,000 largest US companies for the proxy year 2017. (For purposes of funds' proxy vote disclosures on Form N-PX, the SEC defines "proxy year 2017" as July 1, 2016, through June 30, 2017.) Some proposals had multiple sponsors.

Source: Investment Company Institute tabulations of ISS Corporate Services data

These proponents generally are pursuing specific interests. Some are unions or pensions that submit proposals trying to effectuate change among public companies. Other proponents are activist investors who are trying to promote awareness of specific issues or to compel companies to take certain actions.

By identifying the proponents who submitted shareholder proposals, we can highlight the differences in the types of issues they raised. Figure 2 shows that the two of the more active groups of sponsors—individuals and pension funds for state and local workers—concentrated their energies on shareholder proposals related to governance, submitting 124 out of 150 proposals on board structure and elections and 58 out of 79 proposals on shareholder rights and takeover defenses.

Activists who identify themselves as "socially responsible investors" accounted for 43 percent of social and environmental proposals (110 out of 253). Pension funds and advocacy groups also actively submitted proxy proposals related to social and environmental issues. Collectively, the four most active constituencies submitted 86 percent of the shareholder proposals that funds voted on last year.

FIGURE 2

Sponsorship of Shareholder Proposals by Type of Proposal and Proponent, 2017

	Total	Board structure and election process	Shareholder rights/Anti- takeover	Compensation- related	Social and environmental	Other
Individuals	159	70	56	9	10	14
SRI investors ¹	128	2	12	2	110	2
State and local defined benefit pension funds	118	54	2	8	53	1
Advocacy groups ²	57	7	3	2	44	1
Unions	19	3	0	6	10	0
Religious organizations	18	3	0	0	14	1
Registered investment companies (“funds”)	4	0	1	0	2	1
All others	34	11	5	4	10	4
Total	537	150	79	31	253	24

¹ Socially responsible investing (SRI) investors are defined here as registered investment advisers that manage their clients’ assets (typically those of high-net-worth individuals investing through separately managed accounts) in an effort to achieve specific financial and social objectives. Registered investment companies with a mandate to engage companies on social and environmental issues are included in the “funds” category.

² Advocacy groups are defined here as nonprofit organizations whose primary activities are intended to advance certain causes such as human rights, welfare, and environmental issues.

Note: This figure is based on shareholder proposals at the 3,000 largest US companies for the proxy year 2017. (For purposes of funds’ proxy vote disclosures on Form N-PX, the SEC defines “proxy year 2017” as July 1, 2016, through June 30, 2017.) Some proposals had multiple sponsors.

Source: Investment Company Institute tabulations of ISS Corporate Services data

As shareholders in public companies, these proponents have the right to offer their ideas for specific issues or actions that they want companies to pursue. But as this examination shows, the interests of the shareholders who sponsor proposals are likely to be very specifically focused. Funds, by contrast, vote their proxies on behalf of 100 million shareholders in the aggregate—workers saving for retirement, families saving for education, and other households seeking to realize financial goals. Whether those fund shareholders’ interests are served by the objectives of a proposal sponsored by any individual or entity is a decision each fund adviser must make—and does make—consistent with the best interests of the fund and its shareholders and in line with the fund’s investment objective.

Morris Mitler is an economist and Sean Collins is chief economist in ICI Research. Dorothy Donohue is ICI’s deputy general counsel, securities regulation.

This post is the second in a three-part ICI Viewpoints series on funds’ proxy voting through 2017.

NOVEMBER 7, 2018

Funds and Proxy Voting: Funds Vote Thoughtfully and Independently

BY MORRIS MITLER, SEAN COLLINS, AND DOROTHY DONOHUE

During the 2017 proxy voting season, registered investment companies—including mutual funds, exchange-traded funds (ETFs), and closed-end funds—cast more than 7.6 million votes for proxy proposals submitted by either management or shareholders of corporations held in the funds' portfolios. Some of those proposals were straightforward; others were more controversial. But in every case, a fund adviser had a duty to evaluate the proposal and act in the best interest of the fund and its shareholders.

Fund advisers take this duty seriously—and that's borne out by ICI's analysis of proxy voting data for the 2017 season.

Preliminary tallies by ICI Research show that funds vote largely with management on management proposals—reflecting the fact that the vast majority of those proposals (81 percent) are routine votes on uncontested elections of directors or ratification of a company's audit firm. On shareholder proposals, funds' votes are more likely to diverge, based on each fund's investment objective and the fund adviser's assessment of whether a particular proposal serves the interests of that fund's shareholders.

And one finding comes through the data clearly: fund advisers don't automatically follow anyone's recommendations. In particular, funds' votes diverge from the recommendations of Institutional Shareholder Services Inc. (ISS), the largest proxy advisory firm. That matters, because some critics claim that funds' voting is largely dictated by recommendations from proxy advisory services such as ISS and its main competitor, Glass, Lewis & Co.

In two recent *ICI Viewpoints*, we analyzed the types of proxy proposals shareholders submitted during the 2017 proxy season and how those have changed over the years. We also took a look at the identities of the proponents who offered those proposals. Now we're going to examine how funds actually voted on 2017 proxy proposals and how their votes compare with ISS recommendations.

How Funds Vote: Policies and Process

First, however, it's important to understand how funds approach proxy voting.

Proxy voting is the mechanism through which shareholders register their preferences on corporate issues. As shareholders in public companies, funds participate in the proxy voting process on behalf of the investors whose assets they steward. Funds take this responsibility seriously.

Federal law places on a fund's adviser a fiduciary duty to cast votes on proxy proposals in the best interest of the fund and its shareholders. Unlike other investors, funds and their advisers are required by law to establish and disclose written proxy voting policies and procedures that specify, among other things, procedures for addressing potential conflicts of interest in the proxy voting process and how funds may vote on issues. To discharge their fiduciary obligations, funds evaluate individual proxy proposals according to numerous factors, including, among other things, the specifics of the proposal, company performance, and the quality of a company's management.

How Funds Vote: Considering a Range of Factors

In voting proxies, funds consider carefully a range of factors that may include:

- » What vote—"for," "against," or "abstain"—would best advance the interests of the fund and its investors?
- » Would a "for" vote be consistent with the fund's proxy voting policies and procedures?
- » Has this identical proposal appeared on the company's proxy statement in previous years and failed to pass?
- » What are the details of the proposal?
- » Is the proposal one that can be implemented effectively, or would it impose material costs in excess of any benefit?
- » Does the proposal address the general interests of the company's shareholders, or just interests of the particular shareholders who sponsored the proposal?

How Funds Vote: The Role of Proxy Advisory Firms

In carrying out their proxy voting duties, fund advisers may engage the services of a proxy advisory firm like ISS or Glass-Lewis. Proxy advisors offer a range of services including:

- » assisting with the administrative tasks (e.g., generating proxy voting reports);
- » compiling information for funds' annual proxy voting filings with the SEC on Form N-PX;
- » executing proxies according to clients' instructions (e.g., voting fund proxies according to rules the fund has previously specified to the proxy advisor);
- » preparing research reports with recommendations on whether to vote "for," "against," or "abstain" on specific proxy proposals.

Given the scale of funds' proxy-voting responsibilities—in 2017, the average mutual fund voted on 1,504 separate proxy proposals—many fund advisers value the administrative and analytical support that proxy advisory firms can provide.

Some funds, however, do not use the services of a proxy advisor. And some of those that do use the firms do not subscribe to the proxy advisor's research or vote recommendations. Even among funds that do subscribe, funds point out that those vote recommendations are not dispositive.

Those statements are supported by the data on funds' actual voting. Those data demonstrate that, contrary to the claims of some commentators, funds do not vote mechanically according to the vote recommendations issued by proxy advisors.

How Funds Vote: The Data, Please

As Figure 1 shows, in 2017, funds voted “for” almost 94 percent of proxy proposals submitted by management. In comparison, the proxy advisory firm ISS recommended voting “for” about 93 percent of management proposals. This is not surprising. As noted before, the vast majority of management proxy proposals are for routine business items, such as the ratification of the company’s auditor or the uncontested election of a member of the board of directors. Virtually all (99 percent) of the routine proposals passed.

FIGURE 1
Fund Votes on Management Proposals During the 2017 Proxy Season

	Funds ¹	ISS ²	Percentage of shares voted in favor ³	Percentage of proposals passing	Number of proposals
All management proposals	94%	93%	95%	99%	25,377
Election of directors	94	93	96	100	17,847
Ratification of audit firm	98	99	99	99	2,796
Other management proposals	96	92	95	97	4,734
Shareholder rights/Antitakeover-related	87	93	91	65	310
Capitalization	90	90	91	97	170
Director-related	94	94	98	88	121
Compensation-related	89	88	91	98	3,745
<i>Of which:</i>					
Say-on pay	89	88	91	97	2,523
Other	89	88	91	99	1,222
Mergers and reorganizations	98	98	98	98	221
Miscellaneous	88	88	89	96	167

¹ This category is measured as the number of US-registered investment companies recording a “for” vote for proposals in a given category, divided by the total number of votes that funds cast.

² This category is measured as the number of times ISS recommended voting “for” a proposal in a given category, divided by the total number of recommendations ISS made in that category.

³ This category is measured as the number of shares voted in favor, divided by the total number of shares voted, including shares owned by shareholders who abstained from the vote.

Note: This figure represents votes cast by US-registered investment companies during the 2017 N-PX reporting year (fiscal year July 1, 2016, to June 30, 2017). It excludes votes on securities listed on foreign stock exchanges.

Source: Investment Company Institute tabulations of Form N-PX data and ISS Corporate Services data

For management proposals, there is an evident correlation between how funds voted and ISS vote recommendations. That reflects the routine nature of the proposals and their general acceptance by all voting shareholders.

That correlation breaks down, however, when funds vote on shareholder proposals (Figure 2). Shareholder proposals tend to be much more debated than management proposals. Consistent with that, there is greater divergence between how funds voted, what ISS recommended, and vote outcomes. Taking all shareholder proposals as a group, funds voted in support nearly 35 percent of the time. This compares with ISS recommendations to support almost 65 percent of all shareholder proposals. This wide gap suggests that funds reach their own voting decisions, largely independent of recommendations from proxy advisory firms.

FIGURE 2
Fund Votes on Shareholder Proposals During the 2017 Proxy Season

	Funds ¹	ISS ²	Percentage of shares voted in favor ³	Percentage of proposals passing	Number of proposals
All shareholder proposals	35	65	29	13	482
Shareholder rights/Antitakeover-related	49	77	44	33	70
Social/Environmental	25	55	20	2	241
<i>Of which:</i>					
Political contributions and related proposals	34	86	25	0	69
Board structure and election process ⁴	49	82	41	26	121
Compensation-related	28	71	24	4	25
Amend articles, bylaws, or charter	33	50	0	0	2
Miscellaneous	5	12	13	9	23

¹ This category is measured as the number of US-registered investment companies recording a “for” vote for proposals in a given category, divided by the total number of votes funds cast.

² This category is measured as the number of times ISS recommended voting “for” a proposal in a given category, divided by the total number of recommendations ISS made in that category.

³ This category is measured as the number of shares voted in favor, divided by the total number of shares voted, including shares owned by shareholders who abstained from the vote.

⁴ This category represents shareholder proposals calling for, or related to, declassifying boards are included in “antitakeover-related” shareholder proposals.

Note: This figure represents votes cast by US-registered investment companies during the 2017 Form N-PX reporting year (fiscal year July 1, 2016, to June 30, 2017). It excludes votes on securities listed on foreign stock exchanges.

Source: Investment Company Institute tabulations of Form N-PX data and ISS Corporate Services data

Moreover, Figure 2 highlights that funds exercise judgment in weighing different types of shareholder proposals. Fund votes tended to vary both by the types of issues raised and by the details of the individual proposals within a given category.

For example, funds frequently voted to support shareholder proposals relating to corporate governance: Figure 2 shows that funds voted “for” almost half the time in support of shareholder proposals related to board structure and election process. They showed similar support for proposals related to shareholder rights—proposals that typically limit company management’s ability to defend against takeovers. For shareholders, these proposals often improve the chances for transactions that could add value to a company.

In contrast, funds in aggregate tended to provide considerably less support for shareholder proposals related to social or environmental issues—voting “for” such proposals 25.2 percent of the time. Funds with a mandate from their shareholders to support social and environmental goals—often described as socially responsible investing (SRI) funds—typically offer much higher support for such proposals, voting “for” these proposals almost 90 percent of the time. That makes sense: these funds tell investors that they will invest consistent with the objective of advancing social and environmental goals.

This *ICI Viewpoints* series has provided a preliminary look at our analysis of fund proxy voting data. But the message is clear: fund advisers are meeting their obligation to cast votes on proxy proposals in the best interest of their funds and fund shareholders.

Morris Mitler is an economist and Sean Collins is chief economist in ICI Research. Dorothy Donohue is ICI's deputy general counsel, securities regulation.

This post is third in a three-part ICI Viewpoints series on funds' proxy voting through 2017.

OCTOBER 2, 2018

SEC Should Reject Complex, Costly “Pass-Through” Proxy Voting

BY PAUL SCHOTT STEVENS

Policymakers and regulators at the US Securities and Exchange Commission (SEC) have renewed their interest in proxy voting issues recently. Among the items under discussion at an [upcoming SEC Roundtable](#) is the idea that a fund would only be allowed to vote on portfolio company proxies after the fund asks its own shareholders how the fund should vote. In essence, this would “pass through” to fund shareholders the decision of how corporate proxies would be exercised. Even the briefest consideration demonstrates how misguided and impractical the idea is—and why it should go no further.

First, a single fund may invest in hundreds and even thousands of portfolio companies, each with its own annual meeting agenda that may include two or more items for voting. In 2017, for example, the average mutual fund voted on 1,504 separate proxy proposals.

A single fund also may have hundreds of thousands or even millions of shareholders. Those shareholders—young adults saving for a house, parents saving for college, owners of individual retirement accounts, and other Main Street investors—for the most part do not have the time, expertise, or particular views on the myriad of matters, some of them quite complex, that are subject to proxy voting. The “information costs” to fund shareholders of mastering these issues would be extreme.

How do we know this? When funds themselves must solicit proxies from their own shareholders, they find it very difficult to get individual shareholders to vote on matters directly affecting the funds they’ve selected. How much more difficult would it be to get them to respond to a flurry of requests for their views concerning items on the annual meeting agendas of hundreds of companies whose shares are held in the fund?

Second, any pass-through voting or other consultation process would be exceptionally costly and operationally complex. We can estimate roughly how expensive pass-through voting would be based on the analysis we conducted in 2006, when the New York Stock Exchange proposed barring brokers from voting proxies on behalf of their customers for the election of fund directors. ICI analyzed the costs of obtaining retail shareholder proxy votes then and estimated that this one change would double the cost of a typical proxy.

That was just for one proxy solicitation. Passing through and obtaining retail shareholder views on proxies for many hundreds or even thousands of portfolio companies to the estimated 87 million US investors who own stock mutual funds would generate astronomical new costs for shareholders, who bear these costs as fund expenses.

Driving these costs are the many steps funds would need to take to implement pass-through voting, including:

- » identifying the shareholders of record, including those who invest through intermediary omnibus positions;
- » coordinating with intermediaries and their vendors to verify the number of shares each underlying shareholder of an omnibus position holds as of the record date for each underlying security;
- » sorting out different shareholder positions for different securities held within the fund's portfolio;
- » providing in some form timely communications about the issues subject to the companies' proxies, presumably including passing along corporate proxy materials to each fund shareholder;
- » sending multiple notices to fund shareholders to encourage participation;
- » tracking and tabulating the shareholder feedback;
- » determining the most appropriate way in which to cast votes, given that it's unlikely that all—or even a majority—of fund shareholders will respond, and that their preferences will vary on each relevant agenda item;
- » and—the biggest hurdle of all—addressing the fact that shareholders are largely indifferent to proxies in general.

All of these challenges would need to be overcome within the short time frame of the proxy voting period, typically 60 days. Moreover, because most US corporations have a December 31 fiscal year-end, companies tend to flood investors' mailboxes with annual proxies between April and June of each year. The sheer volume of proxies a fund receives for its portfolio holdings would create additional logistical and operational issues for a fund to solicit and track shareholder input on a proxy for every holding in its portfolio (and across the fund complex) over a few months. The impact simply would be enormous, and the additional costs could materially affect investor returns.

Clearly, the notion of passing through the responsibility to vote corporate proxies did not originate with funds or their shareholders. Where then did the idea come from? Some of the voices behind this idea include the so-called Main Street Investors Coalition, backed by groups like the National Association of Manufacturers and the American Council for Capital Formation, who want to limit funds' and other institutional investors' ability to vote in favor of shareholder proposals related to environmental, social, and governance issues. Commentators have **questioned** the degree to which this coalition in fact represents “mom-and-pop investors.”

Nonetheless, the questions raised by the group are getting attention. Recently, **SEC Chairman Jay Clayton stated**, “A majority of Main Street America's dollars are invested in vehicles where the investor.. is not the voting shareholder. Often voting power rests in the hands of investment advisers who owe a duty to vote proxies in a manner consistent with the best interests of funds and their shareholders. A question I have is: are voting decisions maximizing the funds' value for those shareholders?”

ICI would respond to this question with a resounding “yes.” Funds have a fiduciary duty to vote corporate proxies in a manner consistent with the best interest of fund shareholders. Independent directors on fund boards establish the policies and procedures that govern the way in which the adviser will vote, and they oversee this process on an ongoing basis. Registered funds in the United States are unique among institutional investors in that they must disclose how they vote proxies every year—company by company, agenda item by agenda item. It is a transparent process, and one to which they apply considerable expertise precisely to maximize the value of the fund’s investments by conscientiously considering those matters subject to shareholder voting.

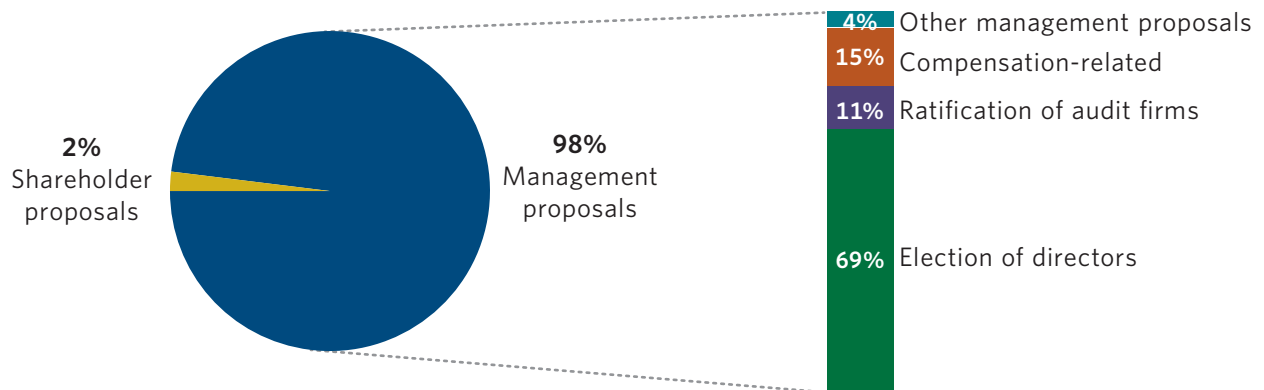
That thoughtful exercise of the proxy franchise in the best interests of the fund and its shareholders is a crucial part of portfolio management, one of the central services that shareholders expect fund advisers to provide. Advisers are already meeting Chairman Clayton’s challenge to ensure that “voting decisions [are] maximizing the funds’ value for those shareholders.” Pass-through voting—forcing advisers to impose that burden on shareholders, at great complexity and expense—would be a giant step in the wrong direction.

Paul Schott Stevens is president and CEO of ICI.

In developing proxy policies, funds may take into account a number of factors, including consistency of the policy with the fund’s investment objective and whether to consider particular categories of proposals similarly or on a case-by-case basis. Factors such as a fund’s investment objective may lead different advisers to reach different conclusions about the expected impact of a proxy proposal (e.g., a merger proposal). Similarly, the same adviser, as the agent for several funds, might reach different judgments when voting for different funds (e.g., funds with or without a specific social or environmental investment objective) and for other advisory clients. As a result, an investment adviser’s votes on a given portfolio company’s proxy proposal might vary among its advisory clients.

FIGURE 1
Proxy Proposals for the Largest Publicly Traded US Companies, 2017

Percentage of total



Note: This figure represents proxy proposals for companies in the Russell 3000 Index with shareholder meetings from July 1, 2016, to June 30, 2017. Components may not add to the total because of rounding.

Source: Investment Company Institute tabulations of ISS Corporate Services data

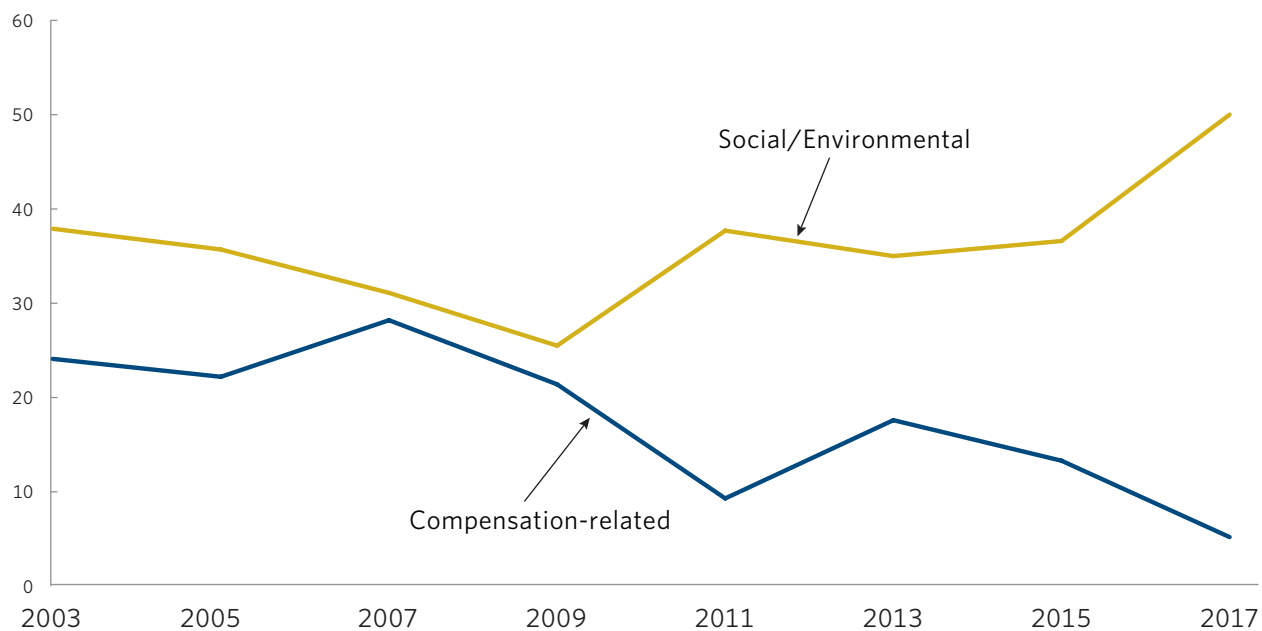
For funds, voting proxies is no small job. In the 2017 proxy season, funds cast 7.6 million votes on 25,859 proposals on corporate proxy ballots. The average mutual fund voted on 1,504 separate proxy proposals. While shareholder-sponsored proposals often draw considerable attention, they make up less than 2 percent of the total (Figure 1). Among the 25,377 management proposals, 80 percent are routine matters—for example, uncontested elections of directors and ratification of a company’s audit firm.

The Changing Proxy Environment

One notable finding of our analysis of proxy voting: the issues funds and other shareholders are asked to vote on have changed dramatically over the years—particularly among shareholder-sponsored proposals.

FIGURE 2
Shareholder Proxy Proposals, 2003-2017

Percentage of the annual number of shareholder proposals



Number of proposals

572	532	650	646	430	535	648	482
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Note: Proxy years consist of dates from July 1 of the preceding year to June 30 of the listed year. Data are plotted for every other year.

Source: Investment Company Institute tabulations of ISS Corporate Services data

For example, the number and proportion of shareholder proposals related to compensation have fallen substantially in the past several years (Figure 2). In part, that’s because of the Dodd-Frank Act. Before Dodd-Frank passed in 2010, many shareholder proposals had called on management to allow shareholders to have an advisory vote on the compensation of corporate executives. These proposals were called shareholder “say-on-pay” proposals. The incentive for shareholders to offer such proposals was eliminated by the Dodd-Frank Act, which requires corporations periodically to solicit advisory shareholder votes on executive compensation.

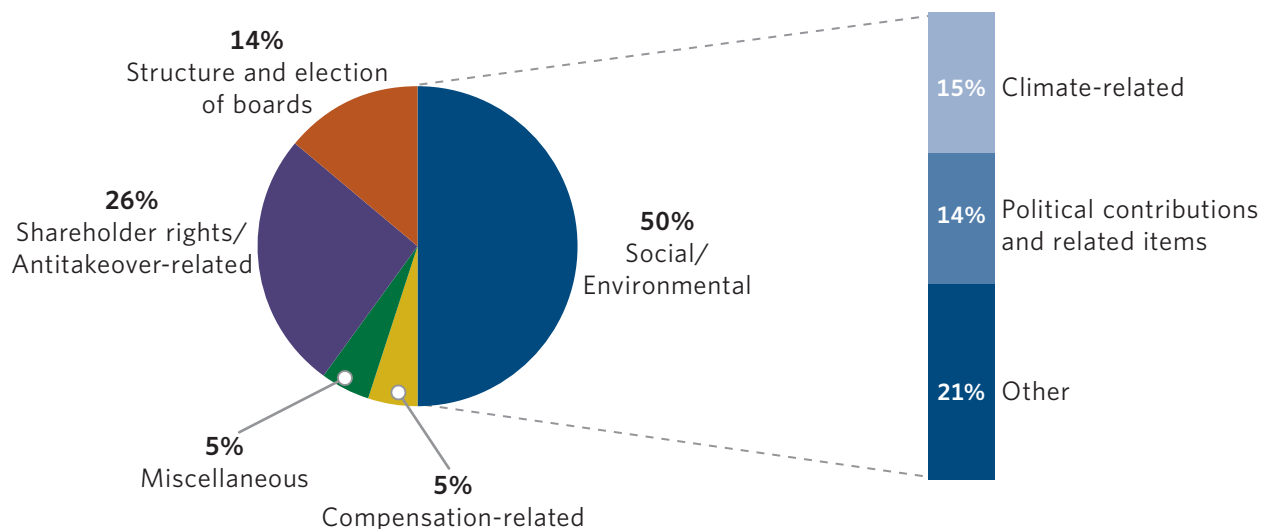
At the same time, as Figure 2 shows, the number and proportion of social and environmental proposals have gone up.

Figure 3 takes a closer look at the 482 proxy proposals that shareholders sponsored in 2017. Of those, 50 percent related to social and environmental issues. Those include climate-related proposals (15 percent of the 482 total proposals) and proposals that called for companies to disclose information on political contributions or related items (14 percent).

The “other” social and environmental category captures a wide range of shareholder proposals, but tends to reflect views that some investors may have about what actions, if any, companies should take in response to recent developments or perceived trends. For example, two shareholder proposals in 2017 called for company reports on “fake news.”

FIGURE 3
Shareholder Proxy Proposals, 2017

Percentage of all proxy proposals sponsored by shareholders



Note: This figure is based on 482 shareholder proxy proposals for companies in the Russell 3000 Index with shareholder meetings from July 1, 2016, to June 30, 2017.

Source: Investment Company Institute tabulations of ISS Corporate Services data

Critics of fund proxy voting often focus on aggregate measures—how funds voted, for example, on all shareholder proposals. Our research has consistently shown, however, that fund advisers carefully consider the nature of each specific proposal in determining how they’ll vote their funds’ proxies. Therefore, in evaluating how funds actually vote, it is critical to distinguish among the mix of shareholder proposals.

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This post is first in a three-part ICI Viewpoints series on funds’ proxy voting through 2017.

Report on Funds' Use of Proxy Advisory Firms

January 2015



Nothing contained in this report is intended to serve as legal advice. Each investment company, investment company board, and investment adviser should seek the advice of counsel for issues related to its individual circumstances.

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I. Background and Introduction

Proxy voting is important to registered investment companies (“funds”) in their capacity as institutional investors. Funds are the beneficial owners of their portfolio securities, and they seek to maximize the value of their voting securities in part through proxy voting.

As part of its fiduciary duty to shareholders, a fund’s board of directors, acting on behalf of the fund, is responsible for the voting of proxies relating to the fund’s portfolio securities. A fund’s board typically delegates proxy voting responsibilities to the fund’s investment adviser in recognition that proxy voting is part of the investment management process.¹ While the nature and extent of this delegation may vary, it remains subject to the board’s continuing oversight.²

When a fund adviser votes proxies, it must do so in a manner consistent with its own fiduciary duties to the fund, and without regard to the fund adviser’s business interests. In addition, a fund adviser must adopt and implement policies and procedures reasonably designed to ensure that it votes proxies in the best interest of the fund, and those policies and procedures must address material conflicts that may arise between the interests of the adviser and the fund with respect to proxy voting decisions.³

A fund must (i) describe in its registration statement the policies and procedures that it uses to determine how to vote proxies relating to portfolio securities⁴ and (ii) file with the Securities and Exchange Commission (SEC) and make available to shareholders the fund’s records of how it voted proxies relating to its portfolio securities.⁵ A fund’s proxy voting policy⁶ is part of its compliance program and subject to the board approval and review requirements of Investment Company Act Rule 38a-1.

¹ Indeed, while fund boards may follow other approaches in voting fund proxies, broad delegation of proxy voting responsibilities to fund advisers is the predominant approach.

² See *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, SEC Release No. IC-25922 (January 31, 2003) (“Investment Company Proxy Voting Release”), at 3. Unless otherwise indicated, this report assumes that the fund board has delegated proxy voting responsibilities, subject to board oversight, to the fund adviser. In addition, the term *fund adviser* is used throughout this report because the information in the report is directed to investment advisers in their capacity as advisers to funds only.

³ See Rule 206(4)-6 under the Investment Advisers Act of 1940 (“Advisers Act”); see also *Proxy Voting by Investment Advisers*, SEC Release No. IA-2106 (January 31, 2003) (“Adviser Proxy Voting Release”). Pursuant to this rule, a fund adviser must also (i) disclose how clients (including funds) may obtain information about how the adviser voted with respect to their securities and (ii) describe its proxy voting policies and procedures to clients and, upon request, provide them with a copy of those policies and procedures.

⁴ See Item 17(f) of Form N-1A (registration statement for open-end funds), Item 18 of Form N-2 (registration statement for closed-end funds), and Item 20 of Form N-3 (registration statement for separate accounts organized as management investment companies). Closed-end funds must also include similar disclosure under Item 7 of their annual Form N-CSR filings.

⁵ See Rule 30b1-4 under the Investment Company Act of 1940 (“Investment Company Act”); see generally the Investment Company Proxy Voting Release.

⁶ The SEC has stated that a fund board could adopt the investment adviser’s policies and procedures, rather than design and adopt distinct policies and procedures for the fund. See the Investment Company Proxy Voting Release at 5.

Fund boards and fund advisers take their proxy voting responsibilities seriously and devote substantial resources to this function.⁷ Because of the number of portfolio securities funds hold and the number of shareholder meetings held by issuers of those securities, efficient and informed proxy voting is a large undertaking. For example, during a 12-month period, ICI research has found that there were more than 20,000 proxy proposals for the 3,000 largest publicly traded U.S. companies.⁸ During that same period, the largest registered fund families cast nearly 4 million separate proxy votes for these particular companies, or an average of nearly 5,000 unique proposals per fund family.⁹ Typically, funds and fund advisers do not have the infrastructure and expertise to handle efficiently all functions related to proxy voting,¹⁰ and therefore they hire third parties such as proxy advisory firms to assist them in carrying out their proxy voting responsibilities.

SEC staff recently released a staff legal bulletin that provides guidance about investment advisers' proxy voting responsibilities and the exemptions to the federal proxy rules that are commonly relied upon by proxy advisory firms.¹¹ The bulletin is the most recent source of guidance from the SEC staff about proxy advisory firms, and provides the staff's broadest discussion to date of an investment adviser's responsibilities in overseeing services provided to it by a proxy advisory firm.¹²

⁷ This report discusses only a fund adviser's oversight of proxy advisory firms. Other aspects of fund proxy voting have been discussed in prior ICI and IDC publications. For example, a broader discussion of fund proxy voting and the roles played by fund boards and fund advisers is provided in *Oversight of Fund Proxy Voting*, Independent Directors Council and Investment Company Institute, July 2008 ("IDC/ICI Proxy Paper"). See also Collins, "Proxy Voting by Registered Investment Companies: Promoting the Interests of Fund Shareholders, 2008," *ICI Research Perspective* 14, no. 1 (July 2008), for a discussion of funds' proxy voting practices.

⁸ See Collins, "Trends in Proxy Voting by Registered Investment Companies, 2007-2009," *ICI Research Perspective* 16, no. 1 (November 2010), at 4.

⁹ *Id.* at 11.

¹⁰ Funds generally do not have employees of their own, so hiring service providers is a common feature of fund operations. See *Board Oversight of Certain Service Providers*, Independent Directors Council Task Force Report, June 2007.

¹¹ See *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*, Staff Legal Bulletin No. 20 (June 30, 2014) ("Bulletin").

¹² Prior to the bulletin, the SEC and SEC staff had addressed in more limited ways investment advisers' use of proxy advisory firms. The Adviser Proxy Voting Release states that, among other ways, an investment adviser could demonstrate that a proxy vote was not a product of a conflict of interest of the adviser if it voted client securities, in accordance with a pre-determined policy, based upon the recommendations of an independent third party. This release does not otherwise address the role of proxy advisory firms in investment advisers' proxy voting processes. SEC staff issued two no-action letters in 2004 (Egan-Jones Proxy Services, SEC No-Action Letter [May 27, 2004] ["Egan-Jones No-Action Letter"], and Institutional Shareholder Services, Inc., SEC No-Action Letter [September 15, 2004] ["ISS No-Action Letter"]) to clarify the foregoing statement in the Adviser Proxy Voting Release regarding how an investment adviser could resolve conflicts of interest that it may face in voting clients' proxies. Finally, the SEC's *Concept Release on the U.S. Proxy System*, SEC Release No. IC-29340 (July 14, 2010) ("Concept Release"), included a discussion of (i) the role and legal status of proxy advisory firms, (ii) concerns about their role, and (iii) potential regulatory responses.

The bulletin recognizes that fund advisers may want or need to evaluate and as necessary make changes to their “current systems and processes” in light of the guidance,¹³ and ICI and IDC understand that some fund advisers have shared, or are in the process of sharing, their findings with their fund boards. To assist fund advisers as they conduct these evaluations, ICI and IDC drew upon the expertise of a member working group to develop a report that focuses on funds’ use of proxy advisory firms. Appendix B identifies the working group members.

Recognizing that funds receive different types and levels of services from proxy advisory firms, the report is organized in a question and answer format, so that readers may focus on items that are of particular interest to them.¹⁴ The questions and answers are organized under the following broad topics: (i) proxy advisory firm services generally, (ii) board oversight of proxy advisory firms, (iii) fund adviser due diligence and oversight of proxy advisory firms, and (iv) miscellaneous considerations related to proxy advisory firm oversight. Appendix A provides references to additional resources, including SEC releases and staff guidance, as well as ICI and IDC publications and other resources.

II. Proxy Advisory Firm Services Generally

What services do proxy advisory firms provide?

Proxy advisory firms provide a number of services that fund advisers may find useful in carrying out their proxy voting responsibilities, including the following:

- » Assisting with the administrative tasks associated with proxy voting, including keeping track of meeting dates and voting instructions, executing proxies in accordance with clients’ instructions (which may include voting in accordance with a fund’s proxy voting guidelines that the proxy advisory firm inputs into its system as part of the fund’s account setup), generating voting reports, providing coverage and translation services with respect to foreign issuers, and compiling information for funds’ annual proxy voting filings with the SEC on Form N-PX
- » Analyzing, providing research, and making voting recommendations on the matters presented for shareholder vote, which fund advisers may take into account to varying degrees in deciding how to vote

¹³ The SEC staff’s expectation is that this will be done “promptly, but in any event in advance of next year’s [i.e., the 2015] proxy season.”

¹⁴ This report is not intended to reflect best practices or to be a model for funds, fund boards, and fund advisers to follow, nor is it intended to be comprehensive. Rather, the information is meant to assist funds, fund boards, and fund advisers as they consider how to fulfill their proxy advisory firm oversight responsibilities. Many of these entities already may be taking actions described in this report, while others may determine that some of the report’s information is not applicable or appropriate given their particular arrangements.

- » Providing research and commentary on trends in prior and upcoming proxy seasons (e.g., shareholder proposals and voting patterns) and general and specific forms of aggregated data, such as data relevant to executive compensation advisory votes
- » Assisting with the formulation of and amendments to proxy voting guidelines, which may be customized or may mirror the standard guidelines of the proxy advisory firm
- » Helping fund advisers mitigate conflict of interest concerns raised when a fund adviser is casting votes on a matter in which its interest may differ from that of the fund¹⁵

III. Board Oversight of Proxy Advisory Firms

What is a fund board's responsibility with respect to the selection and oversight of proxy advisory firms?

A fund board may choose to be involved to varying degrees in the selection and approval of proxy advisory firms and in overseeing proxy advisory firms' performance.¹⁶ The board typically delegates to the fund adviser the day-to-day oversight of the proxy advisory firm.¹⁷ The board could determine to approve a proxy advisory firm based on the fund adviser's recommendation, or it could delegate the selection of the proxy advisory firm to the fund adviser, subject to the board's oversight.

What processes could a board follow to oversee proxy advisory firm performance?

The board's oversight practices with respect to proxy advisory firms generally flow from its oversight practices for proxy voting and service providers generally. Where the board has delegated to the fund adviser the responsibility to provide day-to-day oversight of the proxy advisory firm, the board will rely on the fund adviser to report to it on the firm's performance. Reporting about proxy advisory firms could be included within more general reports or presentations on proxy voting.

¹⁵ See Concept Release at 106 and the IDC/ICI Proxy Paper at 6 for a general discussion of services that proxy advisory firms provide. With respect to resolving conflicts of interest faced by fund advisers, use of proxy advisory firms is just one means of doing so. See *supra*, note 12. See also the appendix to the IDC/ICI Proxy Paper for a discussion of the various ways in which fund advisers identify and resolve potential conflicts of interest that may arise in connection with voting fund proxies.

¹⁶ See IDC/ICI Proxy Paper at 7; see also *Board Oversight of Certain Service Providers*, Independent Directors Council Task Force Report, June 2007, for general guidance regarding how fund boards may evaluate potential service providers and exercise ongoing oversight.

¹⁷ A subadviser may manage some or all of the fund's assets. The subadviser's responsibilities may include voting the fund's proxies with respect to the assets it manages, and the subadviser may use a proxy advisory firm to assist it. The subadviser's proxy voting policy would be subject to the requirement for board review and approval under the SEC's fund compliance rule. See Investment Company Act Rule 38a-1 (which, among other things, requires board approval and annual review of each investment adviser's policies and procedures) and *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IA-2204 (December 17, 2003), at 5-6 and n.17 (stating the SEC's expectation that an adviser's policies and procedures address portfolio management processes, including proxy voting, and noting that subadvisers are a type of service provider to which Rule 38a-1 applies). See *Board Oversight of Subadvisers*, Independent Directors Council Task Force Report, January 2010, at 14 and IDC/ICI Proxy Paper at 8-9 for a discussion of board oversight of a subadviser's proxy voting arrangements.

The board (with the assistance of counsel) and the fund adviser generally will determine the frequency of board reports that include information about proxy advisory firms and the type of information to include in the reports. The topics addressed in board reports as well as their frequency vary and generally depend on the level and types of proxy advisory firm services used. For example, where the fund adviser uses the proxy advisory firm for administrative services only, reports including information about the proxy advisory firm may be more limited and less frequent than would be the case if the fund adviser relied upon the proxy advisory firm's research analysis and voting recommendations as well. Moreover, rather than receive information about all aspects of the proxy advisory firm's services provided to a fund over a given period, the board might prefer exception-based reports. Topics for inclusion in board reports might include:

- » The list or types of services offered by the proxy advisory firm and those services that are being used by the fund adviser
- » The fund adviser's processes for overseeing proxy advisory firms, including the type of information the fund adviser receives from a proxy advisory firm in connection with its oversight
- » The fund adviser's assessment of the proxy advisory firm's capacity and competency to assist it with proxy voting functions on behalf of the fund, which could include information about the quality of the proxy advisory firm's services (e.g., its adherence to customized policies, proportion of missed votes, and accuracy and timeliness in the preparation and filing of the fund's Form N-PX) and the robustness of the proxy advisory firm's policies and procedures regarding its ability to identify and address any potential conflicts of interest that it may face
- » Any material changes or events (such as changes in ownership of or a regulatory action against the proxy advisory firm)

The board reports might include updates (e.g., annual) of pertinent information, such as the proxy advisory firm's guidelines and how the fund adviser uses (or does not use) them.¹⁸

In some cases, proxy advisory firms make presentations at board meetings to educate fund boards about their services.

¹⁸ In addition to regular reports, a board might receive a presentation about its fund adviser's review of its current systems and processes in light of the guidance in the bulletin.

IV. Fund Adviser Due Diligence and Oversight of Proxy Advisory Firms

A. General Considerations

What are a fund adviser's general responsibilities with respect to proxy voting?

A fund adviser owes the fund that it manages a duty of care and loyalty with respect to services undertaken on its behalf, including proxy voting,¹⁹ and a fund adviser with voting authority must adopt and implement policies and procedures reasonably designed to ensure that it votes proxies in the best interest of the fund.²⁰ Assuming the fund board has delegated proxy voting responsibilities to the fund's adviser, the fund adviser is responsible for proxy voting on behalf of the fund, even if it hires a proxy advisory firm to provide certain forms of assistance.²¹

How do a fund adviser's proxy advisory firm oversight responsibilities compare to those related to other service providers?

A fund adviser's oversight of proxy advisory firms is broadly similar to its oversight of any other service provider it may hire to assist it in carrying out a function that it has undertaken to perform. Therefore, in evaluating its proxy advisory firm oversight program, a fund adviser may wish to consider first how it currently exercises oversight of its key service providers. Many of the principles and practices used in those settings are equally applicable to oversight of proxy advisory firms. The fund adviser then can tailor the program for proxy advisory firms based on considerations unique to those firms.

What are some general elements of any oversight program for proxy advisory firms?

The scope of the program will depend on the particular services provided to the fund. If the services that a proxy advisory firm provides are solely administrative, for example, then the scope of ongoing oversight would be more limited than if a fund adviser also uses the proxy advisory firm for proxy voting recommendations or assistance with proxy voting guideline formulation or both. In addition, the oversight program and the fund adviser's due diligence efforts thereunder should be documented.²²

¹⁹ See Adviser Proxy Voting Release at 2, and Bulletin, Question 1.

²⁰ See *supra*, note 3.

²¹ A subadviser may manage some or all of the fund's assets and have day-to-day proxy voting authority. See *supra*, note 17. If the subadviser has proxy voting authority and is using a proxy advisory firm, the information in this report with respect to the fund adviser would generally apply to the subadviser.

²² See SEC ComplianceAlert (July 2008).

B. Initial Due Diligence

If a fund adviser is considering hiring a proxy advisory firm, what could the fund adviser consider covering as part of its initial due diligence review of that proxy advisory firm?

As an overarching principle, when selecting a proxy advisory firm, a fund adviser should consider whether the proxy advisory firm has the capacity and competency to assist with the relevant proxy voting functions.²³ A fund adviser also should consider the anticipated costs and benefits of doing so, as well as those of the alternatives (e.g., use of another proxy advisory firm or service provider, or handling some or all of the functions in-house). A fund adviser typically will consider the 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 to which the proxy advisory firm may be subject.²⁴

Depending on the services to be provided, other matters that a fund adviser may wish to consider or evaluate as part of an initial due diligence review include:

- » Basic organizational information, including information about the proxy advisory firm's owners and affiliates, its internal structure, and key departments (e.g., research,²⁵ operations, information technology, legal, compliance, management, and client service)
- » General information about the proxy advisory firm's (and if applicable, its owners') financial condition,²⁶ and its commitment to this line of business
- » Information about the range of services provided by the proxy advisory firm, how they would complement the fund adviser's capabilities, and what the precise division of responsibilities would be between the proxy advisory firm and the fund adviser
- » Whether the proxy advisory firm has adequate experience, expertise, and resources with respect to the services it would provide to the fund adviser. This inquiry could solicit information about:
 - » The aforementioned departments, along with information about key personnel in each (e.g., education, relevant experience, and tenure with the proxy advisory firm)
 - » The level and quality of servicing, along with the frequency and means of communication (e.g., periodic reporting) it can expect from the proxy advisory firm

²³ See Bulletin, Question 3.

²⁴ See *infra*, Section IV.G. for a discussion of evaluating potential conflicts of interest faced by proxy advisory firms, including factors a fund adviser may consider in evaluating a proxy advisory firm's conflict procedures and the effectiveness of their implementation.

²⁵ See *infra*, Section IV.F. for a discussion of research and recommendations.

²⁶ Registered investment advisers are required to provide certain information about their financial condition to clients pursuant to Item 18 of Part 2A of Form ADV. See *infra*, note 27.

- » The ease of use and capabilities of the proxy advisory firm’s voting platform
- » The extent to which the proxy advisory firm itself relies on third parties for certain services
- » Recent material events affecting the proxy advisory firm (e.g., changes in ownership)
- » Specific terms of the proposed service agreement
- » Certain items related to the proxy advisory firm’s status as a registered investment adviser, if applicable²⁷
- » Information about the proxy advisory firm’s relevant insurance policies
- » The proxy advisory firm’s policies and procedures, compliance systems, and related employee training and education. Policies and procedures to consider reviewing include, as applicable, those related to:
 - » Conflicts of interest
 - » The minimization, identification, and disclosure to clients of errors²⁸
 - » The use and safeguarding of material nonpublic information (including that of the fund adviser) / privacy policies
 - » Communications with issuers and clients
 - » Business continuity and disaster recovery
- » Summaries of internal audits, including whether any relevant weaknesses or issues were uncovered (and if so, how they were addressed)
- » Any other recent reports on the proxy advisory firm’s internal controls, and other reports or measures of the proxy advisory firm’s effectiveness in carrying out its proxy voting responsibilities
- » Information about the proxy advisory firm’s information/data security resources and controls²⁹
- » The proxy advisory firm’s legal and regulatory history, including a description of any relevant legal actions brought against the proxy advisory firm by a regulator or private party
- » Reasonableness of fees in light of services, and how services and fees compare to those of other proxy advisory firms

²⁷ If a proxy advisory firm is a registered investment adviser, a fund adviser may wish to inquire about or review certain items related to registration, such as Form ADV filings, SEC examinations and administrative proceedings, codes of ethics, and annual reviews of compliance policies and procedures. Such an inquiry could be appropriate for both initial and ongoing due diligence reviews.

²⁸ See *infra*, Section IV.H. for a discussion of errors.

²⁹ See ICI’s Information Security Resource Center, particularly “What to Ask When Assessing Information Security Programs,” for specific questions a fund adviser may wish to ask.

The means of conducting evaluations will vary from adviser to adviser, and could include phone calls, written correspondence (including questionnaires), on-site due diligence visits to the proxy advisory firm, visits from the proxy advisory firm, or some combination thereof.

C. Ongoing Due Diligence

Once a fund adviser has hired a proxy advisory firm, how frequently should it evaluate the proxy advisory firm thereafter?

After a fund adviser has completed its review of a proxy advisory firm and its operations and hired the firm, the fund adviser should exercise ongoing oversight of the proxy advisory firm.³⁰ The SEC staff has stated that investment advisers, as part of their ongoing compliance programs, should review no less frequently than annually the adequacy of their proxy voting policies and procedures.³¹ A fund adviser should evaluate whether the proxy advisory firm has performed its duties consistent with the policies and procedures with similar frequency.

There are a number of ways that a fund adviser may keep apprised of significant developments affecting its business relationship with the proxy advisory firm. For example, a fund adviser may schedule recurring reviews or communications with the proxy advisory firm. The frequency and depth of these reviews and communications likely will depend on the nature and extent of the services the proxy advisory firm provides. In addition to a fund adviser's reviews and communications, a proxy advisory firm will sometimes proactively notify the fund adviser of materially significant developments in a proxy advisory firm's business, either on its own initiative or based on expectations set forth by the fund adviser.³²

As part of its ongoing business relationship, a fund adviser could consider providing the proxy advisory firm with performance feedback, as a means of improving performance and the working relationship. This is particularly important when the proxy advisory firm's services are not meeting the fund adviser's expectations. Depending on the nature of the matter, a fund adviser could request a response and follow up as appropriate.

³⁰ See Bulletin, Question 4.

³¹ See Bulletin, Question 1; see also Advisers Act Rule 206(4)-7 and Investment Company Act Rule 38a-1.

³² See Bulletin, Question 4. ICI and IDC understand that proxy advisory firms have different means of proactively conveying information to their clients, including through proprietary platforms and websites that a fund adviser can monitor and review as appropriate. ICI and IDC also understand that proxy advisory firms periodically host conferences and conference calls to cover certain topics of interest. A fund adviser may wish to participate in these forums if the subject matter is relevant to the services it receives from the proxy advisory firm.

What could the fund adviser consider covering as part of its ongoing oversight and due diligence program?

Subsequent reviews could address the proxy advisory firm's actual performance on behalf of the fund since the last review.³³ To this end, a fund adviser could consider ways of assessing proxy advisory firm performance (e.g., whether voting instructions were properly submitted, information regarding any material operational or research-related errors, quality of research reports (if applicable), quality and responsiveness of servicing, etc.).

As part of its ongoing oversight, a fund adviser could request that the proxy advisory firm provide, or provide information about:

- » Material changes (including those pending) to information previously provided by the proxy advisory firm, including that related to:
 - » Operations and ownership structure
 - » Key personnel and resources
 - » Key policies and procedures
- » Adoption of new policies and procedures
- » Initiatives undertaken to improve services or operations
- » Summaries of internal audits and any reviews/audits conducted by third parties, including whether any relevant weaknesses or issues were uncovered (and if so, how they were addressed)³⁴
- » Any relevant legal actions brought against the proxy advisory firm by a regulator or private party
- » Any items identified for follow-up during the period in question or from the previous review

What should a fund adviser do if it learns of material changes to a proxy advisory firm's business?

A fund adviser should evaluate those changes to assess whether the proxy advisory firm continues to have the capacity and competency to adequately provide the relevant proxy services.³⁵

³³ The fund adviser could also consider revisiting certain of the initial review topics discussed above as appropriate.

³⁴ See *supra*, note 27 for additional potential areas of inquiry for a proxy advisory firm that is a registered investment adviser.

³⁵ Cf. Bulletin, Question 4, and the Egan-Jones and ISS No-Action Letters.

D. Oversight of Administrative Functions

How could a fund adviser exercise oversight of administrative functions performed by a proxy advisory firm?

As an initial matter, when a fund adviser begins a business relationship with a proxy advisory firm or launches a new fund to which the proxy advisory firm will provide certain services, the proxy advisory firm, working with the fund adviser and fund custodian, establishes an account for each fund containing the necessary instructions and preferences (e.g., the fund's particular proxy voting guidelines to be applied to proxy proposals). A fund adviser could review this account set-up information to determine if it properly reflects its instructions. Likewise, a fund adviser could review any subsequent changes made to this information and may also consider additional periodic reviews.

If a proxy advisory firm is responsible for releasing voting instructions on behalf of a fund, the fund adviser should periodically assess whether the proxy advisory firm has properly done so.³⁶ This could include reviewing whether:

- » the proxy advisory firm has submitted voting instructions for all of the fund's shares that the fund adviser intended to vote; and
- » those instructions were consistent with the fund adviser's voting instructions, whether based on application of proxy voting guidelines or otherwise.³⁷

E. Proxy Voting Guideline Formulation and Use

What types of proxy voting guidelines do fund advisers establish, and what are some general considerations in their formulation and maintenance?

Subject to board approval, fund advisers may formulate and maintain proxy voting guidelines specifying how they will vote on behalf of their funds on various kinds of proxy proposals. For instance, the guidelines may specify the circumstances under which the fund adviser generally will vote for or against director nominees, executive compensation plans, or social or environmental issues. A fund adviser (or the proxy advisory firm) then votes on specific proxy proposals in accordance with the guidelines. Use of guidelines helps ensure consistency in proxy voting and can help protect against potential conflicts of interest.

³⁶ See Bulletin, Question 1.

³⁷ If a fund adviser uses guidelines and the proxy advisory firm generally has standing instructions to vote in accordance with those guidelines, the fund adviser should periodically review the proxy advisory firm's work in this area. *See id.* For example, the fund adviser could consider reviewing random samples of votes cast, non-routine votes, and/or those votes related to securities in which a fund has a significant economic interest.

Fund advisers that use proxy voting guidelines may adopt: (i) guidelines with no reference to those of a proxy advisory firm, and no input from a proxy advisory firm; (ii) customized guidelines, with varying degrees of similarity to a proxy advisory firm’s standard guidelines and input from the proxy advisory firm; or (iii) a proxy advisory firm’s standard guidelines. Irrespective of a proxy advisory firm’s involvement, the guidelines should reflect the fund adviser’s and board’s views about how to act in the best interest of the fund. Additionally, the fund adviser and the fund board should review the guidelines, including any material changes, at least annually.³⁸

What else could a fund adviser consider if the proxy voting guidelines reflect input from a proxy advisory firm?

A fund adviser that is using or is considering using a proxy advisory firm’s standard guidelines or its own customized guidelines with input from a proxy advisory firm also may wish to consider the following:

- » As part of its initial review, the proxy advisory firm’s standard proxy voting guidelines (including variations thereof that may be of interest—for example, regional- or country-specific guidelines); the reasoning behind the guidelines; the proxy advisory firm’s internal process for reviewing, formulating, and revising its guidelines; and whether the guidelines are consistent with the fund’s best interest.
- » On an ongoing basis, a proxy advisory firm’s material changes to its standard proxy voting guidelines, the reasoning behind those changes,³⁹ and whether the fund adviser wishes to amend its guidelines to incorporate any of those changes.

Will proxy voting guidelines alone provide a sufficient basis for all proxy votes?

No. An application of proxy voting guidelines, no matter how detailed, to proxy proposals will not always yield obvious voting decisions. Some proxy proposals will not have a corresponding guideline that is clearly applicable, and often a fund adviser’s guidelines will require “case-by-case” evaluations of certain complicated or fact-specific proposals (such as merger proposals). For those situations, many fund advisers use proxy advisory firms’ research and recommendations as one resource.

³⁸ See *supra*, note 31.

³⁹ To the extent that it is relevant, a fund adviser may wish to inquire about whether applicable changes in laws, regulations, or norms have been reflected in a proxy advisory firm’s standard regional- or country-specific guidelines.

F. Proxy Advisory Firm's Research and Recommendations

How could a fund adviser assess a proxy advisory firm's proxy voting research capabilities?

As part of its initial review (and subsequent reviews, as appropriate), a fund adviser may wish to assess the resources that a proxy advisory firm dedicates to proxy research and analysis. In doing so, a fund adviser could evaluate the relationship of those resources to the proxy advisory firm's coverage of issuers. In making this evaluation, a fund adviser could request information about the number of issuers the proxy advisory firm typically covers each year, the number of research reports it typically issues each year, and the number of analysts (and other personnel) that are dedicated to proxy research and analysis. As part of initial due diligence, a fund adviser also could review sample research reports to help assess their usefulness.

To the extent that a proxy advisory firm covers foreign issuers, a fund adviser could make a similar assessment of the resources dedicated to that specific coverage. In addition, a fund adviser could inquire about the proxy advisory firm's knowledge of local market conditions and regulations, and whether its guidelines and methodologies reflect them.

What could a fund adviser consider in connection with a proxy advisory firm's voting recommendations?

To understand how a proxy advisory firm analyzes proxy voting proposals and arrives at its ultimate voting recommendations, a fund adviser could inquire about the following:

- » The extent to which the proxy advisory firm's standard guidelines determine ultimate recommendations
- » The information relied upon and parties typically consulted
- » The methodologies and models that influence the proxy advisory firm's recommendations, particularly for those subjects on which the proxy advisory firm formulates recommendations on a "case-by-case" basis⁴⁰

⁴⁰ As part of subsequent reviews, a fund adviser could inquire about whether changes have been made to any policies and methodologies underlying research that materially change the emphasis of the research and resulting recommendations. Cf. Bulletin, Question 4.

G. Proxy Advisory Firm's Potential Conflicts of Interest

How could a fund adviser evaluate the potential conflicts of interest to which a proxy advisory firm may be subject?

Whether and the degree to which a fund adviser should evaluate these potential conflicts of interest depends on the services it receives from the proxy advisory firm. Assessing a proxy advisory firm's potential conflicts of interest is especially important for those fund advisers that rely on a proxy advisory firm's voting recommendations. A fund adviser that does so should consider whether the proxy advisory firm can make recommendations that are in the best interest of the fund, the fund adviser's guiding principle in voting fund proxies.⁴¹ As with any fund service provider, a fund adviser should have an understanding of a proxy advisory firm's:

- » organizational structure, affiliates, lines of business, clientele, and other business relationships, and whether they could give rise to any potential conflicts of interest; and
- » processes for identifying, mitigating, and disclosing its potential conflicts of interest.

A fund adviser could make a determination regarding a proxy advisory firm's impartiality by conducting a thorough review of the proxy advisory firm's conflict procedures and the effectiveness of their implementation.⁴² Taking this approach, a fund adviser could consider assessing:

- » The proxy advisory firm's business and the nature of the conflicts that the business presents
- » The adequacy of the proxy advisory firm's conflict procedures in light of the particular conflicts the proxy advisory firm faces in making voting recommendations, and whether the proxy advisory firm's conflict procedures negate those conflicts⁴³
- » Whether the proxy advisory firm has fully implemented its conflict procedures

A fund adviser could undertake this evaluation at least annually, with the frequency depending in part on the nature and extent of services provided by the proxy advisory firm.

⁴¹ See Advisers Act Rule 206(4)-6(a).

⁴² See ISS No-Action Letter. Alternatively, the fund adviser may consider obtaining from the proxy advisory firm, on a case-by-case basis, any relevant facts regarding the proxy advisory firm's relationship with the issuers of securities, particularly any compensation the proxy advisory firm has received or will receive from such issuers in connection with contracts for services. See Egan-Jones No-Action Letter. The no-action letters offer other possibilities for working with proxy advisory firms that face potential conflicts of interest, and fund advisers may wish to consider them in light of operational feasibility.

⁴³ The SEC staff notes in the ISS No-Action Letter that in doing so "an investment adviser should consider whether the procedures effectively (a) preclude the natural persons who make the firm's proxy voting recommendations from obtaining access to information about the firm's business relationships with [i]ssuers and (b) insulate those persons from direct or indirect influence by the firm's employees who know of those relationships." For instance, if a proxy advisory firm maintains "firewalls" between different lines of business designed to help ensure that proxy advisory personnel are not influenced by other business interests, a fund adviser could evaluate the effectiveness of those firewalls. Such an inquiry could include asking about the features of the firewalls, who monitors the firewalls, any exceptions to the general prohibition on information sharing, whether there have been any breaches and how they were handled, and what improvements have been made to them. See *also* Bulletin, Questions 3 and 4.

What should fund advisers understand about proxy advisory firms' potential conflicts-related disclosure requirements under federal law?

Rule 14a-2(b)(3) under the Securities Exchange Act of 1934 provides an exemption from the information and filing requirements of the federal proxy rules applicable to “solicitations.” Proxy advisory firms commonly rely on this exemption.⁴⁴ To do so, a proxy advisory firm first must assess, if applicable, the significance of its relationship with the company or shareholder proponent, or the materiality of its interest in any such matter; if the proxy advisory firm determines it has a significant relationship or material interest, then it must provide the recipient of the advice with notice of the relationship or interest.⁴⁵

Depending on the nature and extent of services provided by the proxy advisory firm, a fund adviser should understand how the proxy advisory firm is assessing “significance” and “materiality” and providing the necessary disclosure (e.g., in the research report itself or by another means) in fulfilling this requirement. When a proxy advisory firm makes such conflict-related disclosure, that information may be relevant to a fund adviser relying on the related research report and recommendation.⁴⁶ If the report’s analysis or recommendation appears to be inconsistent with the proxy advisory firm’s guidelines, methodologies, or its prior recommendations for proposals with similar fact patterns, or other information that the fund adviser is considering, then the fund adviser could consider seeking clarification from the analyst preparing the report.

H. Review of and Response to Errors

How could a fund adviser generally approach errors related to proxy voting?

At times, it is possible for a fund adviser or a proxy advisory firm to make errors in carrying out its proxy voting functions. While errors in this context can take many forms, they generally can be categorized as (i) operational errors (e.g., a proxy advisory firm could neglect to submit voting instructions on behalf of a fund, fail to vote proxies in accordance with the applicable guidelines, improperly record data for a fund’s Form N-PX filing, or improperly set up a fund’s account), or (ii) errors related to research or analysis (e.g., making an error in a research report).

⁴⁴ The SEC staff bulletin reiterated the SEC’s view that furnishing proxy voting advice constitutes a “solicitation” subject to the information and filing requirements of the federal proxy rules, absent an exemption. Rule 14a-2(b)(3) provides an exemption from certain provisions of the federal proxy rules for “[t]he furnishing of proxy voting advice by any person (the “advisor”) to any other person with whom the advisor has a business relationship” provided certain conditions are satisfied, most notably in this context that “[t]he advisor disclose...to the recipient of the advice any significant relationship with the registrant 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 advisor in such matter.”

⁴⁵ See Bulletin, Questions 10 and 11.

⁴⁶ Cf. the Egan-Jones No-Action Letter and Bulletin, Question 11.

When a fund adviser learns of a material error made by a proxy advisory firm, it should take reasonable steps to 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.⁴⁷ For instance, with respect to a voting-related operational error, a fund adviser may ask the proxy advisory firm to determine the effect of the error on the vote's ultimate outcome. With respect to research, a proxy advisory firm and an issuer may disagree regarding whether a disputed item is in fact erroneous or instead reflects a difference in policy or opinion. If a fund adviser learns of such a disagreement (e.g., through communication with the issuer), it should evaluate the nature of the disagreement and consider how it may impact its voting decision.⁴⁸

How could a fund adviser evaluate a proxy advisory firm's ability to minimize errors and issue accurate and current research reports?

As with any third-party service provider it may employ, a fund adviser could consider the types of errors that it could encounter in its relationship with a proxy advisory firm and then review a proxy advisory firm's policies, procedures, and controls to determine if they are reasonably designed to minimize the occurrence of such errors. For those fund advisers that consult a proxy advisory firm's research reports, the fund adviser may wish to consider the proxy advisory firm's ability to present clear, accurate, and current information in its research reports, including:

- » The process by which reports are reviewed internally and externally and revised
- » How the proxy advisory firm evaluates claims of errors and rectifies them when necessary⁴⁹
- » How and when a proxy advisory firm updates its research and recommendations for other reasons (e.g., in response to new information contained in subsequent regulatory filings from issuers)
- » The proxy advisory firm's process for reevaluating its policies and procedures after learning of errors

⁴⁷ See Bulletin, Question 5.

⁴⁸ Cf. Bulletin, Question 5.

⁴⁹ ICI and IDC understand that proxy advisory firms have processes for amending reports when they discover errors and subsequently notifying their clients. A fund adviser could monitor these amendments for purposes of (i) evaluating the proposals in question and (ii) its ongoing assessment of the proxy advisory firm's competence.

V. Miscellaneous Considerations

A. Review of Policies and Procedures

Should proxy voting policies and procedures and other related materials address the use and oversight of a proxy advisory firm?

The SEC staff’s legal bulletin states that “an investment adviser that has retained a third party (such as a proxy advisory firm) to assist with its proxy voting responsibilities should, in order to comply with the Proxy Voting Rule [i.e., Advisers Act Rule 206(4)-6], adopt and implement policies and procedures that are reasonably designed to provide sufficient ongoing oversight of the third party in order to ensure that the investment adviser, acting through the third party, continues to vote proxies in the best interests of its clients.”⁵⁰ The SEC has recognized in the context of proxy voting that investment advisers have the flexibility to craft policies and procedures suitable to their businesses,⁵¹ and, accordingly, proxy voting policies and procedures will vary depending on the nature and extent of the services received from proxy advisory firms.⁵²

B. Review of Proxy Voting Disclosure

What types of disclosures should funds make regarding their use of proxy advisory firms?

Funds must describe in their registration statements (and, for closed-end funds, in their annual Form N-CSR filings) the policies and procedures that they use to determine how to vote proxies relating to portfolio securities.⁵³ The SEC provided examples of general policies and procedures with respect to which disclosure would be appropriate, including “[t]he extent to which the fund delegates its proxy voting decisions to its investment adviser or another third party, or relies on the recommendations of a third party.”⁵⁴ More generally, the SEC made clear that funds “should be allowed the flexibility to determine the content that would be appropriate for this disclosure.”⁵⁵ Accordingly, fund disclosure will vary depending on, among other things, the nature and extent of the services received from proxy advisory firms.

⁵⁰ The SEC staff cites Advisers Act Rule 206(4)-7 and Investment Company Act Rule 38a-1 in support of this statement. Similarly, in the Egan-Jones No-Action Letter, the SEC staff stated that procedures “should address the use of any independent third party to make recommendations regarding the voting of the proxies of an investment adviser’s clients if the use of an independent third party is a material part of the adviser’s proxy voting policies.”

⁵¹ See Adviser Proxy Voting Release at 4.

⁵² More detailed information about a fund adviser’s use and oversight of a proxy advisory firm may appear in an operating manual or “desktop” procedures.

⁵³ See *supra*, note 4. Under these disclosure requirements, funds are also required to disclose “any policies and procedures of the [f]und’s investment adviser, or any other third party, that the [f]und uses, or that are used on the [f]und’s behalf, to determine how to vote proxies relating to portfolio securities.” Similarly, registered investment advisers must briefly describe in their Forms ADV their voting policies and procedures if they have, or will accept, authority to vote client securities. See Item 17 to Part 2A of Form ADV.

⁵⁴ See Investment Company Proxy Voting Release at 5.

⁵⁵ *Id.*

Appendix A: Additional Resources

SEC Releases

- » *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, SEC Release No. IC-25922 (January 31, 2003), available at www.sec.gov/rules/final/33-8188.htm.
- » *Proxy Voting by Investment Advisers*, SEC Release No. IA-2106 (January 31, 2003), available at www.sec.gov/rules/final/ia-2106.htm.
- » *Compliance Programs of Investment Companies and Investment Advisers*, SEC Release No. IA-2204 (December 17, 2003), available at www.sec.gov/rules/final/ia-2204.htm.
- » *Concept Release on the U.S. Proxy System*, SEC Release No. IC-29340 (July 14, 2010), available at www.sec.gov/rules/concept/2010/34-62495.pdf.

SEC Staff No-Action Letters

- » Egan-Jones Proxy Services, SEC No-Action Letter (May 27, 2004), available at www.sec.gov/divisions/investment/noaction/egan052704.htm.
- » Institutional Shareholder Services, Inc., SEC No-Action Letter (September 15, 2004), available at www.sec.gov/divisions/investment/noaction/iss091504.htm.

SEC Staff Guidance

- » SEC ComplianceAlert (July 2008), available at www.sec.gov/about/offices/ocie/complialert0708.htm.
- » *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*, Staff Legal Bulletin No. 20 (June 30, 2014), available at www.sec.gov/interps/legal/cfs1b20.htm.

IDC/ICI Publications and Other Resources

- » *Board Oversight of Certain Service Providers*, Independent Directors Council Task Force Report, June 2007, available at www.idc.org/pdf/21229.pdf.
- » *Oversight of Fund Proxy Voting*, Independent Directors Council and Investment Company Institute, July 2008, available at www.ici.org/pdf/ppr_08_proxy_voting.pdf.

- » “Proxy Voting by Registered Investment Companies: Promoting the Interests of Fund Shareholders, 2008,” *ICI Research Perspective* 14, no. 1 (July 2008), available at www.ici.org/pdf/per14-01.pdf.
- » *Board Oversight of Subadvisers*, Independent Directors Council Task Force Report (January 2010), available at www.idc.org/pdf/idc_10_subadvisers.pdf.
- » “Trends in Proxy Voting by Registered Investment Companies, 2007–2009,” *ICI Research Perspective* 16, no. 1 (November 2010), available at www.ici.org/pdf/per16-01.pdf.
- » *ICI Information Security Resource Center—What to Ask When Assessing Information Security Programs*, available at www.ici.org/info_security/questions.

Appendix B: Proxy Advisory Firm Oversight Working Group

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