



FIDUCIARY AND INVESTMENT RISK MANAGEMENT ASSOCIATION
29TH NATIONAL RISK MANAGEMENT TRAINING CONFERENCE

PROXY VOTING DUE DILIGENCE

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PROXY VOTING

Who Has the Power/Duty to Vote Proxies?

- A trustee has the duty to actively manage and protect the trust estate, which includes the power to vote proxies related to shares of stock held in a fiduciary capacity.
- A trustee has the duty to act solely in the economic interest of the trust, based on the intentions of the grantor.
- As a fiduciary, an investment adviser owes each of its clients a duty of care and loyalty with respect to the services undertaken on the client's behalf, including proxy voting. An investment adviser with proxy voting authority must monitor corporate events and vote client proxies.
- An investment adviser must cast proxy votes in a manner consistent with the best interest of its clients and must not subrogate client interests to its own.

PROXY VOTING

Types of Proxy Issues

- Routine – Matters that do not include authorization for a merger, consolidation or any matter which may affect substantially the rights or privileges of such stock. Examples include:
 - Election of Directors
 - Selection of External Auditor
- Non-Routine - Matters that do include authorization for a merger, consolidation or any matter which may affect substantially the rights or privileges of such stock. NYSE Rule 452.11 lists twenty-one non-routine proxy issues.

PROXY VOTING

Bank Regulatory Guidance

- Should have internal policies that outline the bank's position for voting proxies and for handling related social or controversial issues. The policy should include a provision that the bank maintain a record of how proxies are voted and, when a decision is made not to vote a proxy, the reasons why that decision was made. The policy should generally require that a trustee vote proxies in the best interest of its clients.
- Should have a policy addressing investments in and voting of own bank stock, holding company stock, or stock of companies for which directors, officers, employees or related organizations have an interest that might interfere with the bank's judgment.

PROXY VOTING

SEC Investment Adviser "Proxy Voting Rule"

17 CFR 275.206(4)-6

- It is a fraudulent, deceptive, or manipulative act, practice or course of business for an investment adviser to exercise voting authority with respect to client securities **unless** the adviser:
 - Adopts and implements written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interests of its clients;
 - Describes its proxy voting policies and procedures to its clients and provides copies upon request; and
 - Discloses to its clients how they may obtain information regarding how their proxies were voted.

PROXY VOTING

- (i) Must adopt and implement **written** policies and procedures that are reasonably designed to ensure the adviser votes proxies in the best interests of its clients.
 - The SEC has given advisers the latitude to create policies and procedures that are tailored to their businesses and the nature of the conflicts they face.
 - There may be times when it is in a client's best interest for an investment adviser to refrain from voting a proxy (e.g., when the adviser determines that the cost of voting the proxy exceeds the benefit to the client.)
 - However, an investment adviser cannot merely refrain from voting proxies in order to avoid a material conflict of interest, as such proxies would not be voted in the client's best interest.

PROXY VOTING

- Procedures must address how the adviser resolves **material** conflicts of interests with its clients.
 - An adviser must take steps to ensure, and be able to demonstrate that those steps resulted in, a decision to vote proxies that was based on the client's best interest.
 - Examples of Material Conflicts of Interests:
 - EXAMPLE – An adviser or affiliate may manage a pension plan, administer employee benefit plans, or provide brokerage, underwriting, insurance or banking services to a company whose management is soliciting proxies. In such cases, the failure to vote with management may harm the adviser's relationship with the company/issuer.
 - EXAMPLE – An executive of the adviser may have a spouse or other close relative that is a director or executive of a company whose stock the adviser must vote.

PROXY VOTING

- Methods of resolving material conflicts:
 - Advisers that vote securities based on a pre-determined voting policy could demonstrate that the vote was not a product of the conflict of interest.
 - Policy must advance the interests of the client rather than those of the adviser. Thus, the adviser cannot adopt a blanket policy of voting in favor of the companies with which it does business.
 - Advisers can suggest that clients engage another party to determine how proxies should be voted.
 - Advisers that vote securities according to a pre-determined voting policy, based on the recommendations of an independent third party, could demonstrate that the vote was not a product of the conflict of interest.

PROXY VOTING

- (2) Must disclose to clients how they may obtain information regarding how their proxies were voted.
 - Most advisers make this disclosure in Form ADV Part 2A Brochure or in an alternative Disclosure Document.

PROXY VOTING

- (3) Must describe proxy voting policies and procedures to clients and provide copies upon request.
 - The description should be a concise summary of the adviser's policies and procedures (not a reiteration of the policies) and should indicate that a copy of the policies and procedures is available upon request.
 - Most advisers make this disclosure in Form ADV Part 2A Brochure or in an alternative Disclosure Document.

PROXY VOTING

SEC Investment Adviser Guidance

17 CFR 275.204-2(c)(2)(i-v)

- Adviser must retain the following records:
 - Copies of all required policies and procedures;
 - Copies of each proxy statement received;
 - Records of each vote cast on behalf of its clients;
 - A copy of each written client request for information on how the adviser voted proxies on behalf of the client, and a copy of any written response by the investment adviser to any client request for information on how the adviser voted proxies on behalf of the requesting client; and
 - Copies of documents created by the adviser that were material to making a decision on how to vote proxies on behalf of a client or that memorializes the basis for that decision.

PROXY VOTING

Third Party Proxy Advisory Firms

- Egan-Jones Proxy Voting Services (January 15, 2004) – Investment advisers must ascertain whether the third-party is capable/competent and can make impartial voting recommendations.
- Staff Legal Bulletin No. 20 (June 20, 2014)
 - The Division of Investment Management provided guidance regarding an investment adviser's responsibilities in voting client proxies and retaining proxy advisory firms.
 - When deciding to retain a proxy advisory firm, an adviser should consider:
 - Whether the proxy advisory firm has the capacity and competency to adequately analyze proxy issues;
 - The firm's staffing and personnel, robustness of policies to ensure proxy voting recommendations are based on current and accurate information and the firm's ability to identify and address conflicts of interest.



PROXY VOTING

Third Party Proxy Advisory Firms

- Staff Legal Bulletin No. 20 (continued.)
 - Ongoing Oversight
 - In order to comply with the Proxy Voting Rule, an adviser should adopt policies and procedures reasonably designed to provide ongoing oversight of the third party to ensure that the adviser, acting through the third party, continues to vote proxies in its clients' best interest.
 - Compliance Programs
 - Advisers can demonstrate compliance with the Proxy Voting Rule by reviewing or sampling proxy votes cast to ensure they are consistent with the adviser's policies and procedures.
 - Investment advisers should also review their policies and procedures at least annually to ensure they are being implemented effectively and continue to be reasonably designed to ensure proxies are voted in the best interests of clients.



QUESTIONS

REFERENCES

- OCC Handbooks (Various)
<http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/index-comptrollers-handbook.html>
- OTS Trust and Asset Management Handbook
<http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/ots/ots-trust-asset-mgmt-handbooks.html>
- FDIC Trust Examination Manual
<http://www.fdic.gov/regulations/examinations/trustmanual/index.html>
- Federal Register Vol.68, No. 26 / Friday, February 7, 2003
<http://www.gpo.gov/fdsys/pkg/FR-2003-02-07/pdf/03-2952.pdf>
- 17 CFR 275.206(4)-6
http://www.ecfr.gov/cgi-bin/text-idx?SID=f76d0028bd9fb8df496d47d4925e822c&node=se17.4.275_1206_24_3_66&rgn=div8
- 17 CFR 275.204-2(c)(2)(i-v)
http://www.ecfr.gov/cgi-bin/text-idx?SID=f76d0028bd9fb8df496d47d4925e822c&node=se17.4.275_1204_62&rgn=div8
- ISS Proxy Voting Guidelines
<http://www.issgovernance.com/policy-gateway/2015-policy-information/>
- Glass Lewis Proxy Voting Guidelines
<http://www.glasslewis.com/resource/guidelines/>