

Regions Investment Management

SEC and Proxy Advisors

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Overview

- * Pros and cons of using a proxy advisor
- * Recent SEC Guidance on use of proxy advisors
- * Proxy advisor due diligence

Pros and Cons of Proxy Advisors

- Why use a proxy advisor?
 - Many institutional shareholders do not have the bandwidth to analyze all proposals and many retail investors treat proxies as junk mail
 - Logistics – they simplify the voting process
 - Proxy advisors are independent and knowledgeable
 - Can have positive effects such as promoting good corporate governance and increasing shareholder engagement
- What are the problems with using a proxy advisor?
 - Are you fulfilling your fiduciary duty
 - Are they focused on maximizing shareholder return
 - There are consistent complaints from management
 - Recommendations based on incomplete or inaccurate info
 - Conflicts of interest
 - Lack of communication

Regulators and Proxy Voting

- 1988 – DoL’s “Avon Letter”
- 2003 – SEC Rule 206(4)-6 of the Investment Advisers Act of 1940
- 2004 – SEC no-action letters
- 2010 – SEC “proxy plumbing” concept release
- 2013 – House FSC hearing “Examining the Market Power and Impact of Proxy Advisory Firms”
- 2014 – SEC staff legal bulletin (SLB 20) regarding proxy voting responsibilities
- 2015 – House FSC approved legislation requiring advisory firms to register with the SEC
- 2018 – SEC staff withdraw no-action letters
- 2018 – SEC roundtable on the proxy process
- 2018 – Corporate Governance Fairness Act introduced
- 2019 - SEC Commissioner comments on robovoting
- 2019 – SEC clarifies investment advisor’s proxy voting responsibilities
- 2020 – SEC adopts rules to provide more transparent, accurate and complete information
- 2021 – SEC proposes rules that would address impairments to timeliness and independence of proxy voting advice

Regulatory Concerns

- What are the SEC's concerns?
 1. Concentration among proxy advisors
 - ISS and Glass, Lewis & Co. together control over 90% of the proxy advisory market
 2. Robovoting
 - Are asset managers passing on their fiduciary responsibility
 3. Disclosures
 - Are investors aware of a manager's reliance on a proxy advisor
 4. Conflicts of Interest
 - Is the advisor's recommendation in the best interest of the client
 5. Accuracy and completeness of information
 - Are there mistakes that are material to the analysis
 6. Dialogue with company management
 - Does the company have a chance to comment on analysis

2019 Guidance on Proxy Voting Responsibilities

1. Agreeing on the scope of your authority and responsibilities
2. Demonstrating that decisions are being made in the client's best interest and in accordance with P&P
3. Considerations when retaining a proxy advisory firm
4. Discovering errors, incompleteness or methodological weakness
5. Evaluating the services of a proxy advisory firm
6. Do you always have to vote proxies on behalf of the client

2019 Guidance on Proxy Voting Responsibilities

- How may an investment adviser and its client, in establishing their relationship, agree upon the scope of the investment adviser's authority and responsibilities to vote proxies on behalf of the client?
- The investment adviser and client may shape the voting authority through full and fair disclosure and informed consent.
- Voting determinations must be consistent with your fiduciary duty and in compliance with Rule 206(4)-6.

2019 Guidance on Proxy Voting Responsibilities

- What steps could an investment adviser take to demonstrate that it is making voting determinations in a client's best interest and in accordance with the investment adviser's proxy voting policies and procedures?
- Do you have a need for multiple proxy voting policies
- Are votes being cast consistently according to policies and procedures
- Are policies and procedures reviewed on an annual basis

2019 Guidance on Proxy Voting Responsibilities

- What are some considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist it in discharging its proxy voting duties?
- Adequacy of staffing and technology
- Does the adviser solicit feedback from issuers and clients
- Does the adviser disclose methodologies for making recommendations
- Review adviser's P&P with specific focus on conflicts of interest

2019 Guidance on Proxy Voting Responsibilities

- What steps should an investment adviser consider when it becomes aware of errors, incompleteness or methodological weakness in the adviser's analysis?
- Are you periodically reviewing your use of the advisory firm's research, including the extent to which errors, incompleteness or methodological weaknesses impacted recommendations
- Are you reviewing the adviser's P&P and are you comfortable with their approach to handling errors, incompleteness or methodological weaknesses

2019 Guidance on Proxy Voting Responsibilities

- How can an investment adviser evaluate the services of a proxy advisory firm that it retains, including evaluating any material changes in services or operations by the proxy advisory firm?
- Are your P&P effective at identifying and evaluating the proxy adviser's conflicts of interest
- Do you receive updates regarding the advisory firm's capacity and competency to provide and execute voting recommendations
- Are you comfortable with the frequency of updates to methodologies, guidelines and voting recommendations

2019 Guidance on Proxy Voting Responsibilities

- If an investment adviser has assumed voting authority on behalf of a client, is it required to exercise every opportunity to vote a proxy for that client?
- Does your agreement with the client cover all possible scenarios
- You may refrain if it is in the best interest of the client
- Do your disclosures cover situations where you may not vote a proxy

Proxy Voting Best Practices

- Committee reviews ISS benchmark policy and policy updates prior to proxy season
- We review our Proxy Committee charter and Proxy Committee Voting Guideline Document
- Discuss potential conflicts of interest
- Review ISS due diligence materials (Policies and Procedures, Code of Ethics, Code of Conduct, Policy Regarding Disclosure of Significant Relationships)
- Perform random sampling of proxy season votes
 - Validate that ISS is voting in line with their benchmark policy
 - Validate that Regions' custom policy is being implemented
 - Validate that securities from the potentially conflicting list are being voted in line with the benchmark policy

Summary

- Proxy voting is receiving more regulatory attention
 - Advisory business is concentrated
 - Growth in passive strategies makes outsourcing voting attractive
 - Companies are pushing back on pay and board contests
- Robovoting is becoming less attractive
- The new approach favors
 - Advisor due diligence
 - Sampling and verification of policy implementation
 - Ability to customize
 - Clear disclosures