

Compliance Date: Advisers must comply with the new rule and amendments by August 6, 2003. Section III of this Release contains more information on the compliance date.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is adopting new rule 206(4)-6 [17 CFR 275.206(4)-6] and amendments to rule 204-2 [17 CFR 275.204-2] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act").¹

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I. Background

Investment advisers registered with us have discretionary authority to manage \$19 trillion of assets on behalf of their clients, including large holdings in equity securities. In most cases, clients give these advisers authority to vote proxies relating to equity securities. This enormous voting power gives advisers significant ability collectively, and in many cases individually, to affect the outcome of shareholder votes and influence the governance of corporations. Advisers are thus in a position to significantly affect the future of corporations and, as a result, the future value of corporate securities held by their clients.

The federal securities laws do not specifically address how an adviser

must exercise its proxy voting authority for its clients. Under the Advisers Act, however, an adviser is a fiduciary that owes each of its clients duties of care and loyalty with respect to all services undertaken on the client's behalf, including proxy voting.² The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies.³ To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner consistent with the best interest of its client and must not subrogate client interests to its own.

An adviser may have a number of conflicts that can affect how it votes proxies. For example, an adviser (or its 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.⁴ Failure to vote in favor of management may harm the adviser's relationship with the company. The adviser may also have business or personal relationships with participants in proxy contests, corporate directors or candidates for directorships. For example, an executive of the adviser may have a spouse or other close relative who serves as a director or executive of a company.⁵

Our concern with these conflicts and how they affect clients of advisers led us to propose, on September 20, 2002, new rule 206(4)-6 and amendments to rule 204-2.⁶ The proposals were designed to prevent material conflicts of interest from affecting the manner in which advisers vote clients' proxies. We proposed to require advisers to adopt and implement policies and procedures for voting proxies in the best interest of

² See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963) (interpreting section 206 of the Advisers Act [15 U.S.C. 80b-6]).

³ As we discuss later in this Release, we do not mean to suggest that an adviser that does not exercise every opportunity to vote a proxy on behalf of its clients would thereby violate its fiduciary obligations to those clients under the Act.

⁴ The adviser may also have a business relationship not with the company but with a proponent of a proxy proposal that may affect how it casts votes on clients' securities. For example, the adviser may manage money for an employee group.

⁵ Whether the adviser's relationships with these other parties creates a material conflict will depend on the facts and circumstances. However, even in the absence of efforts by these parties to persuade the adviser how to vote, the value of the relationship to the adviser can create a material conflict. The Supreme Court has made it clear that the Advisers Act was intended to eliminate or expose advisers' unconscious biases as well as conscious ones. *Capital Gains*, *supra* note 2, at 191-192.

⁶ *Proxy Voting by Investment Advisers*, Investment Advisers Act Release No. 2059 (Sept. 20, 2002) [67 FR 60841 (Sept. 26, 2002)] ("Proposing Release").

clients, to describe the procedures to clients, and to tell clients how they may obtain information about how the adviser has actually voted their proxies.

We received several thousand comment letters; nearly all supported adoption of the rule.⁷ Commenters, including many advisers and groups representing advisers, agreed that advisers should have proxy voting procedures, and supported clients' right to information on how their proxies are voted. Several, however, urged that we revise the proposed recordkeeping requirements of rule 204-2 to make them less burdensome on advisers. We are today adopting rule 206(4)-6 as proposed, and are adopting amendments to rule 204-2 with certain changes that respond to issues raised by commenters.

II. Discussion

A. Rule 206(4)-6, Proxy Voting

Under rule 206(4)-6, it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Act for an investment adviser to exercise voting authority with respect to client securities, unless (i) the adviser has adopted and implemented written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, (ii) the adviser describes its proxy voting procedures to its clients and provides copies on request, and (iii) the adviser discloses to clients how they may obtain information on how the adviser voted their proxies.⁸

1. Advisers Subject to the Rule

The rule applies, as proposed, to all investment advisers registered with us that exercise proxy voting authority over client securities. While several commenters urged that we create exceptions, none offered persuasive

⁷ The Proposing Release was issued with a companion release proposing amendments that would require mutual funds to disclose policies and procedures they use to vote proxies on their portfolio securities, and to make available to their shareholders the specific proxy votes they cast. See *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, Investment Company Act Release No. 25739 (Sept. 20, 2002) [67 FR 60827 (Sept. 26, 2002)] ("Fund Proposing Release"). Commenters submitted ten different types of form letters; five of these (approximately 2800 letters) and a large number of other letters were submitted in response to both the Proposing Release and the Fund Proposing Release. In addition, some letters submitted in response to the Proposing Release also raised points pertaining to the Fund Proposing Release, and vice versa.

⁸ Nothing in this rule reduces or alters any fiduciary obligation applicable to any investment adviser (or person associated with any investment adviser).

¹ Unless otherwise noted, when we refer to rule 204-2 or any paragraph of the rule, we are referring to 17 CFR 275.204-2 of the Code of Federal Regulations in which the rule is published, as amended by this release, and when we refer to rule 206(4)-6 or any paragraph of the rule, we are referring to 17 CFR 275.206(4)-6 of the Code of Federal Regulations as adopted by this release.