



OPINION

The SEC Needs to Robo-Cop the Problem of Robo-Voting

BY J.W. VERRET

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The Securities and Exchange Commission recently adopted new rules and guidance to regulate proxy advisers who wield enormous influence on the outcomes of shareholder votes in corporate elections. The commission found that ISS and Glass Lewis' advice is instrumental in informing the votes of large institutional investors who themselves are responsible for the retirement savings of most main street investors.

The new rules imposed some simple compliance obligations on proxy advisers, including requirements that conflicts of interest be better disclosed and to allow companies about whom these recommendations are made an opportunity to review them for errors.

The SEC also clarified that mutual fund managers and other investment advisers must be mindful of their statutory fiduciary duty when using proxy advisers. In particular, it highlighted the controversial use of "robo-voting" on some leading proxy adviser's platforms, in which funds set their voting decisions on "autopilot".

As Commissioner Elad Roisman [described](#) it, robo-voting allows those funds to "set it and forget it" and that as a result the "proxy voting advice business (is able) to produce recommendations that determine the client's vote, without further action by the client."

The commission's guidance makes clear that "fiduciary Duty cannot be outsourced" and that investment advisers must still fulfill their fiduciary duties to their members when using proxy advisers.

The SEC also stated that if investment advisers decide to vote on behalf of their clients, they cannot fully outsource all voting decisions but must still carry-out their own due diligence. Investment advisers are also required to disclose their use of this controversial practice.

Further, material changes in circumstance like an issuer's response to a proxy adviser's voting recommendation in the case of a contested resolution, requires that an investment adviser



showing that robo-voting is a problem. One academic article in the SEC's comment file by USC Business School scholar Chong Shu showed that the two leading proxy advisers, ISS and Glass-Lewis, together controlled [91 percent of the market](#) for proxy advice.

Shu's research shows that as of 2017, 23 percent of ISS clients blindly follow its recommendations. He argues that "without disabling the automatic voting mechanism, the rule will be much less effective in fixing factual errors", reflecting that "23% of ISS clients are not going to review registrant's response even if they are given a chance to do so.

[Research](#) by Paul Rose makes the case even more strongly by showing that those funds who did not deviate from an ISS recommendation subsequently robo-voted with ISS lockstep another 80,000 times, as of November 2019.

Concerningly, robo-voting severely compounds those instances when proxy adviser recommendations are based on erroneous information. [Research](#) has shown that during the most recent proxy season, there were at least 42 errors in recommendations documented in SEC filings, which aligns with the [rate of errors](#) found during the 2016-2018 proxy seasons, which featured by one count 139 errors in proxy adviser recommendations. This comes despite recent efforts by the Commission to improve the quality of proxy advisers recommendations.

It is clear that proxy advisers did not take prior year's guidance from the SEC seriously (indeed they sued their regulatory to stop the guidance from being issued),so it is doubly important that the commission's compliance officers monitor investment advisers' robo-voting habits as a central part of their efforts to protect main street investors

Only with a united front from the SEC's compliance, enforcement and regulatory team will the proxy advisers and their clients get the message that blindly outsourced robo-voting is a direct breach of investment advisers' fiduciary duties. With that clear message, investment advisers and proxy advisers can better appreciate the basic rules of the road to fulfill their fiduciary duties to their investors.

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