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August 7, 2018

**Filed Electronically**

Mr. Brent J. Fields, Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, N.E.  
Washington, DC 20549

*Re: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, S7-09-18*

Dear Mr. Fields:

We submit these comments in connection with the above-referenced proposal to interpret the fiduciary duty that is imposed on registered investment advisers under the Investment Advisers Act of 1940 ("Advisers Act").<sup>1</sup>

ISS is the world's leading provider of corporate governance and responsible investment solutions for asset owners, asset managers, hedge funds and asset service providers. ISS' solutions include proxy advisory solutions that help institutional investors make informed proxy voting decisions, manage the complex process of voting shares and report their votes to their stakeholders and regulators. Covering roughly 39,000 shareholder meetings a year in over 100 developed and emerging markets, ISS serves millions of hard-working investors who entrust their retirement and investment dollars to pension funds, mutual funds, asset managers and other fiduciaries who use our services.

As part of our proxy advisory solutions, ISS analyzes proxy statements and makes voting recommendations based on more than 400 customized voting guidelines adopted by institutional clients, as well as on ISS' own voting policy options. These include a standard benchmark policy focused solely on protecting shareholder value and mitigating governance risk, and a wide array of specialty policies that evaluate governance issues from the perspective of sustainability, socially responsible investing, public pension funds, labor unions or mission and faith-based investing. As is the case with the custom policies, clients select the ISS benchmark or specialty policy they deem to best serve the interests of their investment or fiduciary managed accounts.

As a registered investment adviser for more than 20 years, and as a service provider to approximately 1000 other registered investment advisers, ISS encounters the practical aspects of fiduciary duty on a daily basis. Our comments are informed by this experience.

**Fiduciary Duties Generally**

The Proposed Interpretation explains that the Advisers Act subjects investment advisers to a federal fiduciary standard of care that requires advisers at all times to serve the best interests of their clients and not to subordinate their clients' interests to their own.<sup>2</sup> While the parameters of an adviser's relationship with a particular client may be shaped by contract, the adviser may not disclaim, and the client may not waive, the fundamental fiduciary duty.

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<sup>1</sup> Advisers Act Release No. 4889 (April 18, 2018) (hereafter, the "Proposed Interpretation"). The release's request for comment on whether the Commission should propose additional rules that would align the Advisers Act regulatory regime more closely with the one imposed on broker-dealers is beyond the scope of this comment letter.

<sup>2</sup> *Id.* at 7.

According to the Proposed Interpretation, the fiduciary standard of conduct for investment advisers is comprised of a duty of care and a duty of loyalty. The duty of care, among other things, entails an obligation to provide advice that is in the best interest of the client and a duty to provide advice and monitoring over the course of the relationship. On a more granular level, the obligation to render advice that is in a client's best interest entails a duty to make and periodically update a reasonable inquiry into a client's "investment profile"<sup>3</sup> and to provide advice that is suitable for and in the best interest of the client, based on that profile. In addition to making a reasonable investigation into the client's needs, an adviser also has a duty to sufficiently investigate the investment in question, in order to reasonably ensure that advice is not based on materially inaccurate or incomplete information.<sup>4</sup> An investment adviser's duty to provide advice and monitoring over the course of the client relationship depends on the scope of the services agreed upon between the adviser and the client, and extends to all personalized advice the adviser provides.<sup>5</sup>

The second prong of the fiduciary standard, the duty of loyalty, forbids an investment adviser from placing its own interests above those of its clients or to unfairly favor one client over another. While this duty obliges an adviser to seek to avoid conflicts of interest with its clients, it does not prohibit conflicts outright. Instead, the adviser must, at a minimum, fully and fairly disclose to its clients all material conflicts of interest that could affect the advisory relationship. This disclosure must be sufficient to enable the client to understand the conflicts and to make an informed decision regarding consent. Where such disclosure cannot be made, the conflict should either be eliminated or mitigated to the point at which effective disclosure is possible.<sup>6</sup>

ISS supports the Commission's proposed interpretation of the fiduciary standard of conduct that applies to investment advisers. We agree that the duty of care entails an obligation to act in a client's best interest which, in turn, entails an obligation to undertake a reasonable investigation into both the client's needs and the advice being rendered. While we also generally agree with the proposed description of the duty of loyalty, we respectfully suggest that an adviser's obligation regarding material conflicts of interest might better be described as a duty to either eliminate such conflicts or to manage and effectively disclose them. Because material conflicts pose the type of business and/or client risk that must be addressed in an adviser's written compliance procedures under Rule 206(4)-7, effective disclosure alone may not suffice.

### **Application of the Fiduciary Standard to Proxy Voting**

The Proposed Interpretation confirms that an investment adviser's fiduciary duties of care and loyalty are not limited to traditional asset management activities, but rather extend to all services undertaken on a client's behalf, including proxy voting.<sup>7</sup> ISS agrees.

The Commission formally addressed the fiduciary nature of proxy voting in 2003, when it adopted Advisers Act Rule 206(4)-6. This rule requires an investment adviser who undertakes to vote proxies on a client's behalf to adopt written policies and procedures reasonably designed to ensure that the adviser monitors corporate actions and votes proxies in the client's best interests and that it does not subrogate client interests to its own. This subjects the adviser to both a duty to match voting guidelines to the client's investment profile and a duty to manage conflicts of interest that might arise in the proxy voting process. While the Commission confirmed that an investment adviser may obtain assistance from independent third parties in

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<sup>3</sup> This term is defined as the client's financial situation, level of financial sophistication, investment experience and investment objectives. *Id.* at 9-10.

<sup>4</sup> *Id.* at text accompanying note 31.

<sup>5</sup> *Id.* at 14-15. The Proposed Interpretation does not address impersonal advisory services. *Id.* at note 8.

<sup>6</sup> *Id.* at 18-19.

<sup>7</sup> *Id.* at notes 24 and 25, *quoting* Advisers Act Release No. 2106 (January 31, 2003) ("Proxy Rule Release").

carrying out its proxy voting responsibilities, both the Commission and the Staff of the Division of Investment Management have made it clear that an adviser's fiduciary duty cannot be delegated to a third party or otherwise disclaimed.<sup>8</sup>

The Commission's position in this regard is in harmony with the position of the U.S. Department of Labor ("DOL"), which has long expressed the view that the decision as to how to vote proxies appurtenant to shares of stock held by ERISA plans is a fiduciary act of plan asset management.<sup>9</sup> Furthermore, as with the Commission's interpretation of the Advisers Act, the DOL has opined that under ERISA, an investment manager would not be relieved of fiduciary liability for any proxy voting decision it makes at the direction of another person.<sup>10</sup>

In its 2010 Concept Release on the U.S. Proxy System, the Commission brought its consideration of the fiduciary implications of proxy voting full circle by confirming that proxy advisory firms are investment advisers subject to the fiduciary standard of conduct under the Advisers Act.<sup>11</sup> As the Proposed Interpretation recognizes, this means that a proxy adviser "has a duty of care requiring it to make a reasonable investigation to determine that it is not basing its recommendations on materially inaccurate or incomplete information."<sup>12</sup> It also has a duty of loyalty requiring it to address conflicts of interest.<sup>13</sup>

Based on our extensive experience in this area, ISS believes that subjecting proxy advisers to the same fiduciary standards that apply to the asset managers who use their services provides a critical layer of protection for investors. Having the option to receive proxy analyses and recommendations based on custom voting policies or a variety of ISS policies geared to different investor needs enables investment advisers to tailor their voting practices to each client's best interest. And the extensive array of policies and procedures ISS has adopted to satisfy its fiduciary duties of care and loyalty<sup>14</sup> make it easier for investment managers to satisfy their own fiduciary obligation to conduct comprehensive due diligence before engaging a proxy advisory service.<sup>15</sup> In short, a harmonized fiduciary standard around proxy voting provides end-to-end protection of investors' best interests.

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<sup>8</sup> Proxy Rule Release at note 8 ("Nothing in this rule reduces or alters any fiduciary obligation applicable to any investment adviser (or person associated [therewith]); SEC Division of Investment Management, Division of Corporation Finance, *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) ("SLB 20"); and Letter from Doug Scheidt, Associate Director and Chief Counsel, SEC Division of Investment Management to Mari-Anne Pisarri, Pickard and Djinis (September 15, 2004) ("ISS Interpretive Letter").

<sup>9</sup> Letter from Alan D. Lebowitz, Deputy Assistant Secretary to Mr. Helmut Fandl, Chairman of the Retirement Board, Avon Products, Inc. (February 23, 1988), 1988 ERISA LEXIS 19, \*5-6.

<sup>10</sup> 1988 ERISA LEXIS 19, \*8.

<sup>11</sup> Advisers Act Release No. 3052 (July 14, 2010) at 109-110 ("2010 Proxy Concept Release").

<sup>12</sup> Proposed Interpretation at note 31, *quoting* the 2010 Proxy Concept Release.

<sup>13</sup> 2010 Proxy Concept Release at 110, *quoting* SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191-192 (1963).

<sup>14</sup> These include robust systems and controls designed to ensure that research reports and vote recommendations include high-quality, relevant information, are accurate, based on the relevant voting policy, and are reviewed by appropriate personnel prior to publication. ISS also commissions regular SSAE 16 audits to ensure compliance with our internal control processes, including our research process. In addition, ISS has adopted and enforces a robust set of policies and procedures reasonably designed to either eliminate, or manage and disclose, material conflicts of interest.

<sup>15</sup> See SLB 20 and ISS Interpretive Letter.



**Institutional Shareholder Services Inc.**

1177 Avenue of Americas, 2<sup>nd</sup> Floor

New York, NY 10036

T: +1.646.680.6300 | F: +1.646.417.6090

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For this reason, ISS urges the Commission to confirm in its final interpretive release that the standard of conduct for investment advisers applies to all services undertaken on a client's behalf, including proxy voting and proxy voting advice that is designed to meet the objectives or needs of specific clients or accounts.

ISS appreciates the opportunity to comment on this important interpretive proposal. We would be happy to supply any additional information you may desire.

Sincerely,

A handwritten signature in black ink, appearing to read "Gary Retelny", is written over a horizontal line. The signature is stylized and includes a large, sweeping flourish at the end.

Gary Retelny, President and Chief Executive Officer

cc: Hon. Jay Clayton  
Hon. Kara Stein  
Hon. Robert Jackson  
Hon. Hester Peirce  
Dalia Blass, Director, Division of Investment Management