

Alerts & Publications

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SEC Proposes Amendments to Proxy Rules Relating to Proxy Voting Advice

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On November 5, 2019, the Securities and Exchange Commission proposed amendments to the proxy rules relating to proxy voting advice. In its [press release](#), the SEC noted that the proposal aims to “enhance the accuracy and transparency of the information that proxy voting advice businesses provide to investors and others who vote on investors’ behalf, and thereby facilitate their ability to make informed voting decisions.” The proposed amendments:

- codify the SEC’s interpretation that proxy voting advice generally constitutes a “solicitation;”
- condition the availability of exemptions to proxy voting advice from the information and filing requirements of the proxy rules upon compliance with additional disclosure and procedural requirements; and
- clarify when the failure to disclose certain information in connection with the proxy voting advice may be considered misleading.

These proposed amendments follow recent [guidance](#) from the SEC in August that confirmed the SEC’s position that advice provided by proxy advisory firms are “solicitations” under the proxy rules and subject to the anti-fraud provisions. As discussed in more detail below, Institutional Shareholder Services (“ISS”) filed a lawsuit against the SEC in response to the SEC’s August guidance a few days before the SEC released the proposed amendments discussed in this client alert.

The proxy rule amendments proposed by the SEC are summarized below:

Proxy Voting Advice Constitutes a “Solicitation”

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The proxy rules define a “solicitation” to include, among other things, any “communication to security holders under circumstances reasonably calculated to result in the procurement, execution, or revocation of a proxy.” In its August interpretive release, the SEC explained that the determination of whether a communication is a solicitation depends upon both the specific nature and content of the communication and the circumstances under which it is transmitted. The SEC noted that factors such as “vote recommendations,” the marketing by proxy advisory firms of their expertise for a fee and providing the advice shortly before a meeting to enhance the likelihood that their recommendations will influence their clients’ voting determinations, point to such voting advice generally constituting a solicitation because it fits within the definition above. The SEC further noted that the voting advice generally would be a solicitation even if the recommendations are based on application of the client’s own tailored voting guidelines and the client does not follow the advice.

The SEC is proposing to codify this interpretation by amending Rule 14a-1(l) to make clear that a “solicitation” exists when a person who markets its expertise as a provider of proxy voting advice sells such advice for a fee and provides a vote recommendation. However, the definition of solicitation as proposed would exclude any proxy voting advice furnished by a person only in response to an unprompted request.

Conditions to Exempt Proxy Voting Advice from Information and Filing Requirements

Under the proxy rules, any person engaging in a proxy solicitation, unless exempt, is generally subject to filing and information requirements. Rules 14a-2(b)(1) and (b)(3) have historically been viewed as potentially available to exempt proxy advisory firms from the information and filing requirements. The SEC is proposing to amend Rule 14a-2(b) to provide that proxy advisory firms will have to comply with certain conditions before availing themselves of these exemptions. The proposed conditions are: (i) disclosure requirements for material conflicts of interests; (ii) procedural requirements related to providing registrants and other soliciting persons with a review and feedback period; and (iii) providing the registrants and other soliciting persons the option to include in the proxy voting advice a hyperlink to the registrant’s or other soliciting person’s views on the advice.

Disclosure of Conflicts of Interest

Proxy advisory firms often engage in activities or have relationships that could affect the objectivity of their advice. Examples include providing voting advice to clients on annual meeting proposals while earning fees from the registrant for providing advice on corporate governance and compensation policies; providing voting advice on a matter in which one of its clients has a material interest, such as a business transaction or a shareholder proposal; or providing ratings to institutional investors of registrants’ corporate governance practices while consulting for registrants to help increase their corporate governance scores. In the proposing release, the SEC noted its belief that clients of proxy advisory firms should receive sufficiently detailed

disclosure about the full extent and nature of any conflicts to assess the potential risks of relying on the voting advice.

The SEC is proposing that, as a condition to availability of existing exemptions from the filing and information requirements of the proxy rules set forth in Rules 14a-2(b)(1) and (b)(3), proxy advisory firms must include prominent disclosure of the following information in any written voting advice (and in any electronic medium used to deliver the advice):

- any material interests, direct or indirect, of the firm or its affiliates in the matter or parties concerning which it is providing the advice;
- any material transaction or relationship between the firm and the registrant, another soliciting person or shareholder proponent in connection with the matter covered by the advice;
- any other information regarding the interest, transaction or relationship of the firm or its affiliates that is material to assessing the objectivity of the proxy voting advice in light of the circumstances; and
- any policies and procedures used to identify, and steps taken to address, any such material conflicts of interest.

Such disclosures would be required to be sufficiently detailed so that the firm's clients can understand the nature and scope of the interest, transaction, or relationship to appropriately assess the objectivity and reliability of the proxy voting advice, and may include the identities of the parties involved and, when necessary, the approximate dollar amount involved. Boilerplate language that such relationships or interests may or may not exist would be insufficient. As proposed, it would also be insufficient for a proxy advisory firm to provide the required disclosures only upon the request of a client.

Review by Registrants of Proxy Voting Advice

In the proposing release, the SEC noted concerns expressed in recent years, particularly from registrants, that there could be factual errors, incompleteness, or methodological weaknesses in information underlying the voting advice of proxy advisory firms that could materially affect the reliability of the voting recommendations and could affect voting outcomes. The SEC further noted concerns by many registrants that they (i) lack an opportunity to review the proxy voting advice before it is disseminated, (ii) do not have meaningful opportunities to engage with the proxy advisory firms to correct potential factual errors or methodological weaknesses in the proxy voting advice before votes are cast, or (iii) do not have a sufficient opportunity to inform investors in a timely and effective way of their contrary views to the proxy voting advice.

To address these concerns, the SEC is proposing that, as a condition to availability of existing exemptions from the filing and information requirements of the proxy rules set forth in Rules 14a-2(b)(1) and (b)(3), proxy advisory firms must provide registrants and other soliciting persons conducting a non-exempt solicitation time to review and provide feedback on the advice before it is disseminated to the firm's clients, with the length

of time provided depending on how far in advance of the meeting the proxy statement is filed. The proposed rules would allow proxy advisory firms to require that registrants and other soliciting persons enter into confidentiality agreements to keep the information received confidential until the firms' clients receive the proxy voting advice.

Proxy advisory firms must provide the following amount of time for registrants or other soliciting persons to review and provide feedback on the proxy voting advice:

- five business days if the definitive proxy statement is filed at least 45 calendar days or more before the meeting;
- three business days if the definitive proxy statement is filed less than 45 but at least 25 calendar days before the meeting; and
- proxy advisory firms do not have to provide the opportunity for review and feedback if the definitive proxy statement is filed less than 25 days before the meeting.

Proxy advisory firms would be required to provide registrants and other soliciting persons a final notice of voting advice no earlier than the expiration of the review and feedback period and no later than two business days prior to delivery of the proxy voting advice to the firms' clients. This timing would provide registrants or other soliciting persons the opportunity to assess the extent to which the proxy advice has changed from the version disseminated during the review period and whether any revisions were made as a result of feedback provided. Under the proposed amendments, this final notice of voting advice has to be given regardless of whether the registrant or other soliciting person provided comments on the version of proxy voting advice received in connection with the review and feedback period.

Hyperlink to Statement of Registrant's views

The proposed amendments also provide that, upon receiving the final notice of voting advice, a registrant or other soliciting person may provide a written statement to the proxy advisory firm setting forth its views in response to the voting advice. The registrant or other soliciting person may also request that a hyperlink (or other analogous electronic medium) to that response be included in the proxy voting advice provided to the firm's clients (and on any electronic medium used to distribute the advice). The registrant or other soliciting person would be required to provide the hyperlink (or other analogous electronic medium) to the proxy advisory firm no later than the expiration of the two-business day period required for the final notice of voting advice. The SEC noted that the purpose of this hyperlink requirement is to provide a more efficient and timely means for a proxy advisor's clients to consider the registrant's (or other soliciting person's) views at the same time the client is considering the proxy voting advice and before making a voting determination. Any written statement provided by a registrant or other soliciting person would constitute a "solicitation," be subject to the proxy rule's anti-fraud provisions and have to

be filed by the registrant or other soliciting person with the SEC as additional soliciting materials no later than the date that the proxy voting advice (and thereby the statement) is provided to shareholders.

In the proposing release, the SEC is cognizant of the fact that there may be a number of implementation details to resolve with respect to this hyperlink requirement, and that effective coordination between proxy advisory firms and registrants or other soliciting persons will be needed. We expect that further technical details on coordinating the process for activating the hyperlink, distributing the voting advice, and filing the additional soliciting materials will be fleshed out upon adoption of any final rules on this topic.

The proposed amendments provide that an immaterial or unintentional failure to comply with the conditions will not result in the loss of exemptions, as long as the proxy advisory firm made a good faith and reasonable effort to comply and uses reasonable efforts to substantially comply as soon as practicable after becoming aware of its noncompliance.

Anti-Fraud Provisions Apply to Proxy Voting Advice

In its August guidance, the SEC noted that proxy voting advice is subject to the anti-fraud provisions. Accordingly, “any person engaged in a solicitation through proxy voting advice must not make materially false or misleading statements or omit material facts, such as information underlying the basis of its advice or which would affect its analysis and judgments that would be required to make the advice not misleading.”

Rule 14a-9 currently provides four examples of what may be misleading within the meaning of the rule. The SEC is proposing to amend the list of examples to highlight the types of information that a proxy advisory firm may need to disclose to avoid a potential violation of the anti-fraud provisions. The example added would include the failure to disclose information such as the proxy advisory firm’s methodology, sources of information, and conflicts of interest. These items are consistent with those noted by the SEC in its August guidance. The SEC is also proposing to add to the list the failure to disclose the use of standards or requirements that materially differ from relevant standards or requirements that the SEC sets or approves. In proposing to add this item, the SEC noted a concern that due to the lack of clear disclosures, clients of proxy advisory firms may be led to mistakenly believe that the unique criteria used by the proxy advisory firm were approved or set by the SEC. An example the SEC provided in the proposing release is when a proxy advisory firm may recommend against the election of a member of the registrant’s audit committee on the basis that the director is not independent under the firm’s independence standard for audit committee members, and the standard applied by the firm is more limiting than the SEC’s.

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Although there has been a strong movement seeking to curb the influence of proxy advisory firms with additional regulations, there has also been strong opposition to further regulation. A few days before the SEC’s

release proposing the amendments described above, ISS filed a lawsuit against the SEC in response to the SEC's August interpretive guidance, seeking injunctive and declaratory relief, and expressing its concern that the guidance could impede ISS' ability to deliver its advice in an independent and timely manner. In its lawsuit, ISS argues that the guidance is unlawful because it exceeds the SEC's statutory authority under Section 14(a) of the Exchange Act and is contrary to the plain language of the statute since "the provision of proxy advice is not a proxy solicitation and cannot be regulated as such." ISS also argues that the guidance is procedurally improper because it is a substantive rule that the SEC failed to promulgate pursuant to the notice-and-comment procedures, and is arbitrary and capricious because, "even though it marks a significant change in the regulatory regime applicable to proxy advice, the SEC has denied that it is changing its position *at all*." Separately, in October, the Council of Institutional Investors ("CII") and a coalition of 60 other investors and investor organizations submitted a comment letter to the SEC opposing further regulation and CII subsequently submitted a comment letter further discussing the lack of evidence of pervasive factual inaccuracies in proxy advisors' reports. CII also issued a press release on the date of the SEC's proposed amendments criticizing the SEC for proposing rules that CII believes undercuts critical shareholder rights. There will no doubt be further debate in light of these proxy rule amendments proposed by the SEC.

The SEC's proposing release is available [here](#) and comments are due 60 days following publication in the Federal Register.
