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Alerts & Publications

SEC Adopts Amendments to Proxy Rules Relating to Proxy Voting Advice

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KEY CONTACTS

John-Paul Motley
Los Angeles
D: +1-213-430-6100

Shelly Heyduk
Newport Beach
D: +1-949-823-7968

Robert Plesnarski
Washington, DC
D: +1-202-383-5149

Su Lian Lu
Century City
D: +1-310-246-6746

On July 22, 2020, the Securities and Exchange Commission adopted amendments to the proxy rules relating to proxy voting advice. In its press release, the SEC noted that the amendments aim to "facilitate the ability of those who use proxy voting advice – investors and others who vote on investors' behalf – to make informed voting decisions without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice." The amendments:

- codify the SEC's longstanding view that proxy voting advice generally constitutes a "solicitation" under the Exchange Act's proxy rules;
- condition the availability of exemptions to proxy voting advice from the information and filing requirements of the proxy rules upon (i) enhanced disclosures of conflicts of interest; and (ii) policies requiring notice of proxy voting advice and review of company responses to that advice; and
- clarify when the failure to disclose certain information in connection with the proxy voting advice may be considered misleading.

These final rules follow the proposed amendments in November 2019 and guidance from the SEC in August 2019 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.

The SEC's adopting release is available here and the amendments are summarized below:

Proxy Voting Advice Constitutes a "Solicitation"

The SEC has long held the view that the furnishing of proxy voting advice generally constitutes a solicitation governed by the Exchange Act's proxy rules. The amendments codify this interpretation by amending Rule 14a-1(l) to make clear that the terms "solicit" and "solicitation" include any proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder approval is solicited, and that is furnished by a person who markets its expertise as a provider of such advice, separately from other forms of investment advice, and sells such advice for a fee. The amendments also make clear that any proxy voting advice provided by a person who furnishes such advice only in response to an unprompted request is not a "solicitation."

In adopting the amendment, the SEC noted its belief that the furnishing of proxy voting advice by a person who has decided to offer such advice, separately from other forms of investment advice, to shareholders for a fee, with the expectation that its advice will be part of the shareholders' voting decision-making process, is conducting the type of activity that raises the concerns about inadequate or materially misleading disclosures that the proxy rules are intended to address.

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. The exemptions that have historically been available to exempt proxy advisory firms from the information and filing requirements are Rules 14a-2(b)(1) and (b)(3). The amendments add a new Rule 14a-2(b)(9) which provides certain conditions that proxy advisory firms will have to comply with to avail themselves of the exemptions from the filing and information requirements. The conditions are: (i) disclosure requirements for material conflicts of interest; and (ii) policies requiring notice of proxy voting advice and review of company responses to that advice.

Disclosure of Conflicts of Interest

New Rule 14a-2(b)(9)(i) provides that, as a condition to availability of 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 (or in any electronic medium used to deliver the advice):

- any information regarding an interest, transaction, or relationship of the proxy voting advice business (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship; and
- any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship.

The SEC noted its intent to avoid an overly prescriptive disclosure requirement with specific monetary thresholds, in favor of a more principles-based rule that is flexible enough to cover a wide variety of circumstances that may not fall within pre-determined parameters but nevertheless could materially impact a client's assessment of the proxy advisor's objectivity. The final rules provide the proxy advisor discretion to determine the situations which warrant disclosure and the level of detail to provide based on its judgment of whether the information is material to an evaluation of its objectivity.

In adopting the rule, the SEC noted its belief that increased transparency regarding a proxy advisor's conflicts of interest would place the proxy advisor's clients, including investment advisers, in a better position to understand these conflicts and how they may affect the business's proxy voting advice and other

services.

Notice of Proxy Voting Advice and Review of Company Responses ("Procedural Requirements")

The other condition to the availability of exemptions from the filing and information requirements of the proxy rules set forth in Rules 14a-2(b)(1) and (b)(3) is in new Rule 14a-2(b)(9)(ii) which provides that the proxy advisor has to adopt and publicly disclose written policies and procedures reasonably designed to ensure that:

- companies that are the subject of proxy voting advice have such advice made available to them at or prior to the time when such advice is disseminated to the proxy advisor's clients; and
- the proxy advisor provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by companies that are the subject of such advice, in a timely manner before the shareholder meeting (or, if no meeting, before the votes, consents, or authorizations may be used to effect the proposed action).

In response to comments received, the SEC did not adopt the proposed rule which would have required proxy advisory firms to provide companies time to review and provide feedback on the advice before it is disseminated to the firm's clients. In addition, in a change from the proposed rule, the final rule does not require any subsequent changes made to voting recommendations by the proxy advisor to be disseminated to registrants

Safe Harbors to Procedural Requirements

The final rules provide a non-exclusive safe harbor in Rule 14a-2(b)(9)(iii) that, if followed, will give assurance to a proxy advisor that it has met the principles-based requirement of new Rule 14a-2(b)(9)(ii)(A) to provide notice to companies that are the subject of proxy voting advice. Proxy advisors will be deemed to satisfy this requirement if it has written policies and procedures that are reasonably designed to provide companies with a copy of its proxy voting advice, at no charge, no later than the time it is disseminated to the business's clients. Such policies and procedures may include conditions requiring that such companies have:

- filed their definitive proxy statement at least 40 calendar days before the shareholder meeting; and
- expressly acknowledged that they will only use the proxy voting advice for their internal purposes and/or in connection with the solicitation and it will not be published or otherwise shared except with the company's employees or advisers.

Another non-exclusive safe harbor provided by the final rules in Rule 14a-2(b)(9)(iv) relates to the requirement in Rule 14a-2(b)(9)(ii)(B) that proxy advisors provide clients with a mechanism by which they can reasonably be expected to become aware of company responses to the proxy advice in time to consider the materials before they cast their final vote. To be covered by the safe harbor, the proxy advisor must have written policies and procedures reasonably designed to inform clients who have received proxy voting advice about a particular company in the event that such company notifies the proxy advisor that the company either intends to file or has filed additional soliciting materials with the SEC setting forth its views on such advice. The proxy advisor may either:

- provide notice on its electronic client platform that the company has filed, or has informed the proxy advisor that it intends to file, additional soliciting materials (and include an active hyperlink to those materials on EDGAR when available); or
- provide notice through email or other electronic means that the company has filed, or has informed the proxy advisor that it intends to file, additional soliciting materials (and include an active hyperlink to those materials on EDGAR when available).

Exclusions from Procedural Requirements

The final rules provide that the Procedural Requirements do not apply to proxy advice based on custom policies that are proprietary to a proxy advisor's client. The term "custom policies" does not include a proxy advisor's benchmark or specialty policies, even if those benchmark or specialty policies were to be adopted by the proxy advisor's client as its own policy. If the client adopts a benchmark or specialty policy as its own policy, then the Procedural Requirements apply to the proxy advice that is based on the benchmark or specialty policy.

In addition, the Procedural Requirements do not apply when proxy advisors provide proxy voting advice as to non-exempt solicitations regarding certain M&A transactions specified in Rule 145(a) of the Securities Act or contested solicitations. The exception from the Procedural Requirements only applies to the portions of the proxy voting advice relating to the applicable M&A transaction or contested solicitation and not to proxy voting advice regarding other matters presented at the shareholder meeting.

The SEC noted, however, that proxy voting advice that is based on proprietary custom policies is considered a "solicitation" within amended Rule 14a-1(l), and is subject to the anti-fraud rules of Rule 14a-9 and the conflicts of interest disclosure requirements under new Rule 14a-2(b)(9)(i) discussed above. The same applies for proxy voting advice in connection with M&A transactions and contested solicitations.

Anti-Fraud Provisions Apply to Proxy Voting Advice

The SEC had previously noted in its August 2019 interpretive 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. This list of examples is being amended by the final rules to provide also that the failure to disclose material information regarding proxy voting advice, "such as the proxy advisory firm's methodology, sources of information and conflicts of interest" could, depending upon particular facts and circumstances, be misleading.

The SEC did not adopt the proposal 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.

Compliance Dates

Proxy advisors will not be required to comply with the new conflicts of interest disclosure requirements and Procedural Requirements until December 1, 2021. Practically, this means that calendar year-end companies will not benefit from these new requirements for their annual meetings of shareholders until the 2022 proxy season. However, the SEC welcomes early compliance with the requirements. In addition, the amendments to the definition of solicitation in Rule 14a-1(l) and the anti-fraud provisions in Rule 14a-9 will become almost immediately effective (60 days after the final rules are published in the Federal Register).

Supplemental Guidance to Investment Advisers

The SEC also supplemented its previous guidance to investment advisers regarding their proxy voting responsibilities in light of the proxy rule amendments. The supplemental guidance assists investment advisers in assessing how to consider issuer responses to recommendations by proxy advisor firms that may become more readily available to investment advisers, including in circumstances in which the investment adviser utilizes a proxy advisory firm's electronic vote management system that "pre-populates" the adviser's ballots with suggested voting recommendations or for voting execution services.

The supplemental guidance states that an investment adviser should consider whether its policies and procedures address circumstances where the investment adviser has become aware that an issuer intends to file or has filed additional soliciting materials with the SEC after the investment adviser has received the proxy advisory firm's voting recommendation but before the submission deadline for proxies to be voted at the shareholder meeting. The supplemental guidance suggests that in such cases, if an issuer files such additional information sufficiently in advance of the submission deadline and

such information would reasonably be expected to affect the investment adviser's voting determination, the investment adviser would likely need to consider such information prior to exercising the voting authority in order to demonstrate that it is voting in its client's best interest.

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As discussed in our client alert on the proposed amendments, in October 2019, Institutional Shareholder Services ("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. Following the SEC's proposed rules in November 2019, ISS and the SEC agreed that the litigation would be held in abeyance until the earlier of January 1, 2021 or the promulgation of the final rules. The status of this litigation following the SEC's adoption of final rules is uncertain, but it would not be unexpected for ISS to continue with the lawsuit in light of its significant objections to SEC regulation of proxy voting advice.

Separately, the Council of Institutional Investors ("CII") issued a press release on the date of the SEC's final rule amendments criticizing the SEC for adopting the rules without first issuing a revised proposal and draft guidance and seeking public comment. In its press release, CII claims that the final rules could cause significant delays in the proxy voting process because investment advisors will need to take into account any additional soliciting information filed by issuers and may jeopardize the independence of proxy advisors who may feel pressure to tilt voting recommendations in favor of management to avoid critical comments from companies.

There will no doubt be further debate on this topic despite the adoption of the final rules by the SEC.

This memorandum is a summary for general information and discussion only and may be considered an advertisement for certain purposes. It is not a full analysis of the matters presented, may not be relied upon as legal advice, and does not purport to represent the views of our clients or the Firm. John-Paul Motley, an O'Melveny partner licensed to practice law in California, Shelly Heyduk, an O'Melveny partner licensed to practice law in California, Robert Plesnarski, an O'Melveny partner licensed to practice law in the District of Columbia, and Su Lian Lu, an O'Melveny senior counsel licensed to practice law in California, contributed to the content of this newsletter. The views expressed in this newsletter are the views of the authors except as otherwise noted.