ALERTS

SEC Issues Final Rule Regulating Proxy Voting Advice

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On July 22, 2020, the SEC adopted a final rule confirming its position that proxy voting advice is a solicitation under the proxy rules subject to antifraud provisions and imposing certain new disclosure requirements on proxy advisory firms who wish to avoid the information and filing requirements applicable to proxy solicitations.

Proxy Advice a Solicitation Under the Proxy Rules. The SEC amended Rule 14a-1(l) to codify its view that proxy voting advice constitutes a "solicitation" under Section 14(a) of the Exchange Act. Specifically, the SEC added a paragraph 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 SEC has excluded proxy voting advice in response to an unprompted request. The SEC noted that one-off advice or services by investment advisers or broker-dealers to their clients, which may include proxy voting advice, do not pose risks as they are not marketing their expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and selling such proxy voting advice for a fee.

While this general position is not new, the SEC introduced certain disclosure requirements that must be satisfied in order for proxy advisory firms to be able to avail themselves of the exemptions they had traditionally relied on. In the past, proxy advisory firms, such as ISS, Glass

Lewis and Egan-Jones, had taken the position that they are exempt under Rule 14a-2(b)(1) and Rule 14a-2(b)(3) from the information and filing requirements otherwise applicable to non-exempt solicitations. With the new SEC rules, in order to use those existing exemptions, the proxy advisory firms will need to adopt policies that provide certain new disclosures.

Disclosure of Conflicts of Interest. The SEC's new rule conditions the exemptions in Rules 14a-2(b)(1) and 14a-2(b)(3) on providing disclosure of material conflicts of interest. Proxy advisers must include in their voting advice, or in any electronic medium used to deliver the advice, such as a client voting platform, prominent disclosure of:

- Any information regarding an interest, transaction or relationship of the proxy adviser (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.

Company Review and Feedback to Proxy Voting Advice in Uncontested and M&A Situations. The SEC further conditioned the availability of the exemptions in Rules 14a-2(b)(1) and 14a-2(b)(3) on proxy advisory firms adopting and publicly disclosing certain written policies.

First, the SEC's new rules require a proxy advisory firm to adopt policies and procedures to ensure that their proxy voting advice is made available to the companies subject to it simultaneously with or prior to providing it to their clients. Importantly, the proxy advisory firms are not required to provide an opportunity for a preview to the companies in advance of the issuance of the report. Instead their policies can provide that they will distribute their voting recommendations contemporaneously to their clients and to the subject company.

The SEC has provided a non-exclusive safe harbor provision that, if followed, will give assurance to a proxy adviser that it has met the requirements of the new rule. Under the safe harbor, a proxy advisory firm can adopt 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' clients. Such

policies and procedures may include conditions requiring that such companies have (A) filed their definitive proxy statement at least 40 calendar days before the shareholder meeting; and (B) 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. A proxy adviser is not required to provide copies of any revised or supplemented advice to the subject company.

Second, a proxy voting advisory firm must adopt policies to provide 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).

Here again the SEC provided a non-exclusive safe harbor pursuant to which proxy advisers will be deemed to satisfy the new requirement. To satisfy this safe harbor, a proxy adviser 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 adviser that the company either intends to file or has filed additional soliciting materials with the SEC setting forth its views regarding such advice. The safe harbor sets forth two methods by which the proxy adviser may provide such notice to its clients. It may either (A) provide notice on its electronic client platform that the company has filed, or has informed the proxy adviser that it intends to file, additional soliciting materials (and include an active hyperlink to those materials on EDGAR when available); or (B) provide notice through email or other electronic means that the company has filed, or has informed the proxy adviser that it intends to file, additional soliciting materials (and include an active hyperlink to those materials on EDGAR when available).

These review and feedback requirements are not applicable where the proxy adviser is providing advice based on custom voting policies that are proprietary to a proxy adviser's client.

Importantly, the review and feedback requirements are also not applicable to non-exempt solicitations for the approval of an M&A transaction or contested director elections. The Commission rightfully recognized that the time constraints and frequent changes in contested elections and

M&A situations would make compliance with the review and feedback requirements impractical and disruptive.

Antifraud Provisions. The SEC amended Rule 14a-9, the antifraud provision of the federal proxy rules, to add an example that clarifies that, depending upon the particular facts and circumstances at issue, the failure to disclose certain information in proxy voting advice may be considered materially misleading within the meaning of the rule. Specifically the Note to Rule 14a-9 will include new paragraph (e) to provide that the failure to disclose material information regarding proxy voting advice, "such as the proxy voting advice business's methodology, sources of information, or conflicts of interest" could, depending upon particular facts and circumstances, be misleading within the meaning of the rule.

Compliance Date. The SEC has provided for a transition period until Dec. 1, 2021 for proxy advisers to adopt review and feedback policies and otherwise bring themselves in compliance with the amendments to Rule 14a-2(b)(9). The amendments to Rule 14a-1(l) and 14a-9 which clarify that proxy voting advice is a solicitation subject to the proxy rules antifraud provisions are not viewed by the SEC as new law but merely a clarification of the SEC's existing position and therefore the SEC does not believe a transition period is needed.

Practical Implications for Investment Advisers, Institutional Investors and Activists. Investment advisers, institutional investors and activists count on proxy advisers for timely, independent and well-informed analyses and recommendations. Investment advisers are subject to fiduciary duties in voting on behalf of their clients. Because of the excessive cost of formulating a customized voting decision for each of the thousands of companies and situations where an adviser must vote the recommendations of proxy advisers to various degrees are incorporated in the voting guidelines and internal systems they follow in making voting decisions. In contested situations in particular, proxy advisers play an important role in bringing an independent third-party perspective on issues in dispute between the two competing sides. (A separate *SRZ Alert* on the SEC's supplemental guidance regarding the proxy voting responsibilities of investment advisers will be forthcoming.)

The new SEC rules have the potential to impose operating and compliance costs on proxy advisers that can strain their resources and jeopardize their ability to provide timely and well-researched advice.

Disclosures of conflicts of interest or scrutiny of proxy advisers' methodologies and sources of information may create pressure on investors to put less stock into the proxy advisers' voting recommendations. The review and feedback mechanisms, even though only applicable in uncontested situations, can give undue advantage to subject companies and undermine the independent critical analysis of their performance and governance.

In contested situations, activists would need to engage more deeply with fellow shareholders to understand whether there is a change to how they factor proxy advice into their voting decisions. Engagement with the proxy advisers in presentations of the activist's platform will need to be tailored to be in step with any changes to the practices and approach of the proxy advisers as a result of the new regulations.

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