Corporate

SEC Amends Rules Governing Proxy Solicitation and Voting Advice by Proxy Advisory Firms

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Introduction

On July 22, 2020, the Securities and Exchange Commission, or the Commission, adopted new amendments to its rules governing proxy voting advice provided by proxy advisory firms.[1] The amendments codify the Commission's view that proxy voting advice is generally a "solicitation" under Section 14(a) of the Securities Exchange Act of 1934, or the Exchange Act, and therefore subject to Federal proxy rules. The amendments also add conditions to the exemptions from the information and filing requirements under Section 14(a) of the Exchange Act and the rules thereunder. These conditions include disclosure of conflicts of interest and timely making available proxy voting advice to public companies in order to provide more opportunity for feedback and response. Lastly, the amendments provide additional clarification on when failing to disclose certain information in proxy voting advice could violate the Federal proxy rules' antifraud provision.

The amendments reflect the Commission's efforts to help ensure transparency, accuracy, and completeness in the information available to investors, particularly in situations where shareholder democracy is at stake. The amendments also reflect the Commission's receptiveness to comments, as it revised several of the larger changes that were part of the November proposed rules in response to comments and, in the authors' view, take into consideration critical input from the several proxy advisory firms.

Rules At a Glance
1. Proxy advisory firms' voting advice will be considered a "solicitation" under the Federal proxy rules.
2. To benefit from current exemptions related to filing and information requirements with respect to such proxy advice, proxy advisory firms will need to take additional steps to disclose any material conflicts of interest and provide advice and feedback mechanisms.
3. Proxy voting advice will be subject to the antifraud provisions of Rule 14a-9 of the Exchange Act.
4. Rules 1 and 3 above are scheduled to be effective 60 days after publication in the Federal Register, and the additional exemption requirements noted under Rule 2 above will be effective December 1, 2021.

Proxy Voting Advice as Solicitation

Quick Background—Why Solicitation Matters and Current Exemptions from Filing and Disclosure

As a reminder, Exchange Act Section 14(a) and the rules thereunder make it unlawful for any person to "solicit" any proxy in respect of securities registered under Exchange Act Section 12 in contravention of the Commission's rules and regulations. Pursuant to these proxy rules, persons making a solicitation must comply with filing and disclosure rules to ensure that shareholders receiving the solicitation

receive information that is materially accurate.[2]

The terms “solicit” and “solicitation” are not defined in the Exchange Act, so their meaning has been subject to the Commission’s rulemaking authority. The circumstances under which proxy voting advice will constitute a solicitation was not squarely addressed by the Commission until it released interpretive guidance in 2019.[3] In that release, the Commission outlined factors it considers in making a determination, including the specificity of a vote recommendation, the payment of a fee by the client, and the timing of the advice in relation to the shareholder meeting or authorization vote. This guidance did not have the same authority as the formal rules issued by the Commission.[4]

Proxy advisory firms have been able to rely on exemptions from the filing and disclosure requirements discussed above under Rule 14a-2(b) of the Exchange Act. Under these exemptions, proxy advisory firms do not need to file their recommendations regarding election of directors, approval of equity plans, etc., that they provide to their clients. As discussed in more detail below, the amendments preserve these exemptions but will require proxy advisory firms to provide additional disclosures and feedback procedures in order to continue to qualify for these exemptions.

Proxy Voting Advice is Solicitation under the Federal Proxy Rules

The amendments codify when proxy voting advice constitutes a solicitation. Under amended Rule 14a-1(l)(1)(iii), the definition of solicitation includes any proxy voting advice that: (i) makes a recommendation to a security holder, (ii) as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, (iii) that is furnished by a person who markets its expertise as a provider of such proxy voting advice, (iv) separately from other forms of investment advice, and (v) sells such proxy voting advice for a fee.[5] Moreover, even if such advice is formulated pursuant to the custom policy of a client, rather than pursuant to the proxy advisory firm’s own policies and guidelines, it will nonetheless constitute a solicitation under the amendments.

The Commission also amended Rule 14a-1(l)(2) to clarify that proxy voting advice furnished in response to an unprompted request is not a solicitation. Part of this distinction derives from the fact that persons who receive unprompted requests are likely not preemptively complying with all federal proxy rules, including the new conditions described below. In addition, the Commission does not view such narrow requests for proxy voting advice to pose a greater risk to the broader investor group.

<u>Exemption Conditions: Disclosure of Conflicts of Interest</u>

If proxy voting advice is deemed to be a solicitation pursuant to Rule 14a-1(l), a proxy advisory firm may qualify for an exemption from certain Federal proxy rules (including the filing and disclosure obligations noted above) pursuant to Rule 14a-2(b). The Commission continues to support this framework, but it will now condition the use of the exemptions found in Exchange Act Rule 14a-2(b)(1),[6] or the Proxy Authority Exemption, and Exchange Act Rule 14a-2(b)(3),[7] or the Business Relationship Exemption, on compliance with additional obligations.

One obligation introduced with the amendments is the disclosure of any conflicts of interest which are material to the proxy voting advice furnished to a shareholder. The Commission identified numerous circumstances when it believed that conflicts of interest could arise, such as when a proxy advisory firm provides recommendations to a shareholder about a public company’s upcoming vote while also earning fees from that public company for consulting services. And even though some proxy advisory firms already maintain robust conflict of interest policies and firewalls between advisory and consulting groups, the Commission believed it would be beneficial to investors to prescribe uniform minimum standards.

Specifically, new Rule 14a-2(b)(9)(i) is a principles-based standard that will require proxy advisory firms to include in their proxy voting advice (or in any electronic medium used to deliver the advice) prominent disclosure of:

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

This principles-based standard is intended to be flexible to the unique facts and circumstances of each person relying on a relevant exemption. Similar materiality standards have worked well in other areas of federal securities laws, such as many disclosure requirements under Regulation S-K, and the Commission expects it will not be overly burdensome in this context either.[8]

Exemption Conditions: Advice and Feedback

The other obligation introduced with the amendments is the obligation to facilitate additional dialogue between proxy advisory firms and public companies about vote recommendations. At bottom, the Commission's goal was to provide for and facilitate more "back and forth" between proxy advisory firms and public companies regarding their advice.

Thus, new Rule 14a-2(b)(9)(ii) will require proxy advisory firms adopt and publicly disclose written policies and procedures which are reasonably designed to accomplish two new objectives. First, when a public company is the subject of proxy voting advice, such advice will need to be made available to the public company at or prior to when such advice is disseminated to the proxy advisory firm's clients. There is no prescribed manner or timing in which the proxy advisory firm and public company must interact,[9] but the Commission did create a safe harbor to provide some level of assurance regarding communications. Specifically, the written policies and procedures will be deemed satisfactory if they "are reasonably designed to provide registrants with a copy of its proxy voting advice, at no charge, no later than the time it is disseminated to the business's clients." The safe harbor will apply the same if the written policies and procedures require public companies to file their definitive proxy statement at least 40 calendar days before the shareholder meeting and/or expressly agree to certain confidentiality conditions.

The second objective of new Rule 14a-2(b)(9)(ii) entails providing the proxy advisory firm's clients with a mechanism where the client can reasonably be expected to become aware of any written statements regarding the proxy voting advice by the public company which is who the subject of such advice, in a timely manner before the security holder meeting or similar authorization vote. In other words, there must be a method by which clients of the proxy advisory firm can be notified of any "rebuttals" to the proxy voting advice the proxy advisory firm provided. Clients may be informed either through the proxy advisory firm's electronic client platform, by email, or by other electronic means, in each case with a hyperlink to any available additional materials.

Notwithstanding the above, the Commission created certain exceptions from the new Rule 14a-2(b)(9)(ii) for circumstances that do not call for the same type of discourse with a public company. For example, if proxy voting advice is based on a proprietary or custom policy of a client, there is no need to provide such advice to the applicable public company. As well, there is an exception for proxy voting advice that pertains to non-exempt solicitations (*i.e.*, subject to the information and filing requirements of Rule 14a-3(a)) regarding certain mergers and acquisitions or contested matters.

Altogether, the Commission anticipates this new notice and feedback framework will improve the information available to shareholders. It is worth noting that new Rule 14a-2(b)(9)(ii) changed the most between proposed and final form,[10] reflecting the considerable number of comments from several stakeholders in the process.

Antifraud Provision

Lastly, the Commission is revising Exchange Act Rule 14a-9, which is the antifraud provision for Federal proxy rules. The rule encompasses all solicitations as defined by Rule 14a-1(l), including solicitations which are exempt from certain Federal proxy rules pursuant to Rule 14a-2(b). The

Commission issued guidance in 2019 which affirmed the antifraud provision applies to proxy voting advice and outlined the types of information that may need to be disclosed in order to avoid a potential violation. The new amendments codify this position by adding to the Note to Rule 14a-9 a new example of what may be misleading, depending upon the particular facts and circumstances. The new example reads:

> Failure to disclose material information regarding proxy voting advice covered by [new Rule 14a-1(l)(1)(iii)(A)], such as the proxy advisory firm's methodology, sources of information, or conflicts of interest.

Ultimately, the Federal courts and practices of various market participants for proxy voting advice will help inform this materiality standard.

Compliance Dates

Proxy advisory firms will not need to comply with the new amendments to Rule 14a-2(b)(9) until December 1, 2021. The amendments to Rule 14a-1(l) and Rule 14a-9 will become effective 60 days after publication in the Federal Register.

5 Practice Pointers For Public Companies	
1.	**Design on the front end**: Consult with investor relations, legal, compensation consultants, and proxy design firms to craft readable disclosure that is logically organized and easy to locate. In particular, companies should carefully consider proxy advisor firms' analysis from the previous year and evaluate the new policies in updating any disclosure.
2.	**Structure response team**: In connection with the design of the proxy statement, consider which parties will receive the proxy advisor feedback and are tasked with responding before the proxy is filed. Consider which directors will be notified and part of the response team.
3.	**Build response task list into proxy calendar for response team**: While the filing and furnishing of the proxy statement may mark the end of the proxy process for some members, notify the response team of the intended timeframes that you expect to receive the proxy advisory firm recommendations and when any responses will be due. Should any directors be part of the response team, provide ample notification for them.
4.	**When advice is received, consider whether to file additional soliciting materials and notify the proxy advisory firm that you will be doing so**: With the response team, consider whether any additional soliciting or supplemental materials will be filed and notify the proxy advisory firm regarding the timeline regarding the filings.
5.	**Ensure usability and readability of any additional materials in the Commission's EDGAR system**: Many additional soliciting or supplemental materials are created using graphics and charts. Make sure that such information is readable and accurate for any investors who may be viewing the materials from a separate portal or link.

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[1] *Exemptions from the Proxy Rules for Proxy Voting Advice*, Release No. 34-89372 (July 22, 2020), https://www.sec.gov/rules/final/2020/34-89372.pdf. While the Commission adopted a new term "proxy voting advice business" under Rule 14a-2(b)(9) of the Exchange Act, the authors will refer to such firms

as “proxy advisory firms” in this alert.

[2] Many shareholders have been subject to solicitations when there is “proxy contest” with a company-nominated slate of directors and a shareholder-nominated slate of directors.

[3] *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice*, 84 FR 47416 (Sept. 10, 2019), https://www.govinfo.gov/content/pkg/FR-2019-09-10/pdf/2019-18355.pdf.

[4] On October 31, 2019, Institutional Shareholder Services filed a lawsuit against the Commission challenging the Commission’s 2019 release on procedural and substantive grounds. *See ISS v. SEC et al.*, 1:19-cv-03275 (D. D.C. filed 10/31/19). Earlier this year, the district court granted the Commission’s motion to hold the case in abeyance until the earlier of January 1, 2021 or the promulgation of final rules by the Commission.

[5] Whether the Commission has the authority under the Exchange Act to issue such rules remains an open question as of the time of writing this alert.

[6] The exemption under Rule 14a-2(b)(1) generally applies to persons who do not seek the proxy authority of a security holder.

[7] The exemption under Rule 14a-2(b)(3) generally applies to persons who have a business relationship with the recipient of proxy voting advice and give financial advice in the ordinary course of business. This exemption is commonly relied on by investment advisers with respect to the advice given to their clients.

[8] The authors opine that, similar to conflicts of interest issues regarding investment banking firms, the evaluation and disclosure of these conflicts of interest will be of more interest to plaintiff’s firms rather than ordinary investors.

[9] The Commission’s proposed rule provided public companies the opportunity to review proxy voting advice in advance of when it would be disseminated to clients. The final rule does not go so far, although providing such advice in advance to public companies “would satisfy the principle and is encouraged to the extent feasible.” *Exemptions from the Proxy Rules for Proxy Voting Advice*, Release No. 34-89372 at 93 (July 22, 2020), https://www.sec.gov/rules/final/2020/34-89372.pdf. Some proxy advisory firms already provide certain public companies proxy voting advice in advance. *See id.* at 93 n.339.

[10] For example, the rule as proposed required proxy advisory firms to provide their voting advice to public companies for review in advance of providing it to clients.

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