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SEC Adopts New Rules for Proxy Advisors and Provides Supplemental Guidance on Voting Responsibilities of Investment Advisers

Proxy Advisors Required to Provide Notice of Company Responses to Recommendations and Comprehensive Disclosure of Conflicts of Interest

SUMMARY

On July 22, the SEC amended its proxy solicitation rules to require proxy voting advice businesses, such as ISS and Glass Lewis, to provide their clients with "reasonable and timely access to more transparent, accurate and complete information on which to make voting decisions." Key changes include:

- Revising the definition of "solicitation" under Exchange Act Rule 14a-1(l) to expressly include proxy voting advice (subject to certain exceptions);
- Revising Rules 14a-2(b)(1) and (b)(3) to require proxy voting advice businesses to satisfy the following conditions (set forth in new Rule 14a-2(b)(9)) in order to be exempt from the information and filing requirements of the proxy rules:
  - disclose conflicts of interest in their proxy voting advice; and
  - adopt and publicly disclose policies and procedures requiring the timely dissemination of proxy voting advice to registrants and notice to clients of registrants' responses; and
- Adding to the proxy rules' antifraud provisions examples of when a failure to disclose material information (*i.e.*, the proxy voting advice business's methodology, sources of information, or conflicts of interest) in proxy voting advice could be considered misleading under Rule 14a-9.

Simultaneously with these amendments, the SEC also supplemented its August 2019 guidance[1] on the relationship between an investment adviser's exercise of voting authority on behalf of its clients and its

fiduciary duty and other obligations under the Investment Advisers Act of 1940. Among other things, the supplemental guidance clarifies investment advisers' disclosure and client consent obligations when using a proxy voting advice business's automated voting features (often referred to as "robo-voting"), particularly where a registrant issues a response to proxy voting advice.

The SEC approved the amendments and the supplemental guidance by a 3-to-1 vote, with Commissioner Lee dissenting on both actions.[2] The full text of the amendments is available here, the supplemental guidance is available here, and the SEC's press release announcing these changes is available here.[3] The amendments will become effective 60 days after publication in the Federal Register, although proxy voting advice businesses will not be required to comply with the new Rule 14a-2(b)(9) conditions until December 1, 2021. The supplemental guidance will become effective upon its publication in the *Federal Register*.

PROXY SOLICITATION RULE AMENDMENTS

Definition of "Solicitation" under Rule 14a-1(l)

The amendments to the proxy solicitation rules (the "Amendments") codify the SEC's view, previously outlined in its August 2019 interpretive guidance, that the term "solicitation" in Rule 14a-1(l) captures proxy voting advice. Rule 14a-1(l) now provides that a "solicitation" includes any proxy voting advice that (1) makes a recommendation to a shareholder as to its vote, consent or authorization on a specific matter for which shareholder approval is solicited, and (2) 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. In contrast, as codified under new paragraph (v) of Rule 14a-1(l)(2), proxy voting advice will not be deemed to be a solicitation if it is provided by a person who furnishes such advice only in response to an unprompted request.

The SEC also noted that, for proxy voting advice businesses that distribute more than one proprietary voting policy or set of guidelines (for example, ISS has a general proxy voting guideline as well as several "thematic" proxy voting guidelines), the proxy voting advice generated based on each policy or set of guidelines constitutes a distinct solicitation under Rule 14a-1(l).

Conditions to Qualify for Proxy Solicitation Exemptions Under Rules 14a-2(b)(1) and (b)(3)

Rule 14a-2(b)(1) and (b)(3) currently provide exemptions to the proxy rules' information and filing requirements for (1) solicitations by persons who do not seek the power to act as proxy for a shareholder and do not have a substantial interest in the subject matter of the communication and (2) proxy voting advice furnished by a proxy voting advice business to any person with whom it has a business relationship. In order for proxy voting advice to qualify for the exemptions under the Amendments, a proxy voting advice business must meet "principles-based" conditions under new Rule 14a-2(b)(9)(ii). To provide proxy voting advice businesses with assurance that their policies and procedures comply with these new conditions, the

Amendments also outline non-exclusive safe harbors. These conditions and related safe harbors are summarized below.

- ***Conflicts of Interest Disclosure (Rule 14a-2(b)(9)(i))***: A proxy voting advice business must include in its proxy voting advice (or any electronic medium used to deliver such advice) prominent disclosure of (1) 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 (2) any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest.
- ***Disclosure to Registrants and Notice of Registrant Responses (Rule 14a-2(b)(9)(ii))***: A proxy voting advice business must have adopted and publicly disclosed written policies and procedures reasonably designed to ensure that:
  - its proxy voting advice is made available to the registrant that is the subject of such advice *at or prior to the time* the proxy voting advice is disseminated to the proxy voting advice business's clients (Rule 14a-2(b)(9)(ii)(A)). Notably, the initially proposed amendments would have required the notice to be provided *prior* to dissemination with an opportunity for the registrant to review and provide feedback on the proxy voting advice.

    Safe harbor: A proxy voting advice business will be deemed to satisfy the requirements of Rule 14a-2(b)(9)(ii)(A) if its written policies and procedures 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. These policies may include conditions requiring that the registrant (1) has filed its definitive proxy statement at least 40 calendar days before the shareholder meeting and (2) acknowledge that the registrant will use the proxy voting advice only for internal purposes and/or in connection with the solicitation and that the registrant will not publish or otherwise share the proxy voting advice except with the registrant's employees or advisers.
  - clients are provided with a mechanism by which they can reasonably be expected to become aware of any written statements by the registrant regarding such advice in a timely manner prior to the relevant shareholder meeting, so that the clients can take the registrant's views into account when they make voting decisions (Rule 14a-2(b)(9)(ii)(B)).

    Safe harbor: A proxy voting advice business will be deemed to satisfy the requirements of Rule 14a-2(b)(9)(ii)(B) if its written policies and procedures are reasonably designed to provide notice (via its electronic client platform or through email or other electronic means) to clients who have received proxy voting advice about a particular registrant if that registrant has filed (or informed the proxy voting advice business of its intention to file) additional soliciting materials related to the proxy voting advice. A proxy voting advice business will be deemed to satisfy this requirement if such procedures take the form of (a) a notice on the electronic client platform of the proxy advice business that the registrant has filed, or has informed the proxy voting advice business that it intends to file, additional soliciting materials (including an active hyperlink to those materials on EDGAR when available), or (b) a notice provided through email or other electronic means that the registrant has filed, or has informed the proxy voting advice business that it intends to file, additional soliciting materials (including an active hyperlink to those materials on EDGAR when available).

  In a change from the initially proposed amendments, the Amendments do not require any subsequent changes made to voting recommendations by the proxy voting advice business to be disseminated to registrants.

When Failure to Disclose Material Information About Proxy Voting Advice May Constitute Violation of Proxy Rules Anti-Fraud Provisions

Rule 14a-9 prohibits any proxy solicitation, including those made in reliance on an exemption, from containing false or misleading statements with respect to any material fact at the time and in light of the circumstances under which the statements are made. Similarly, solicitations must not omit material facts that are necessary in order to make the statements therein not false or misleading. The amended Rule 14a-9(e) now includes examples of when the failure to disclose certain material information in proxy voting advice could be considered misleading under Rule 14a-9. In particular, the failure by a proxy voting advice business to disclose its methodology, sources of information or conflicts of interest could, depending on the particular facts and circumstances, render its proxy voting advice materially misleading.

Notably, the SEC had initially proposed to also include as an example of materially misleading conduct situations where the proxy voting advice business did not disclose its use of corporate conduct and reporting standards that materially differ from relevant standards or requirements set by the SEC. The SEC has omitted that example in response to comments. However, the rulemaking release emphasizes that neither the addition of the new examples, nor the exclusion of the initially proposed example, is intended to broaden or narrow the assessment of whether disclosure is materially misleading, which remains a facts and circumstances analysis.

Potential Impact of Conflict of Interest Disclosure Requirements

The new requirement under the Amendments to disclose conflicts of interest may have an impact on the ability of investors, including activists, to privately consult with proxy voting advice businesses prior to the issuance of voting advice. In a footnote in the release regarding the Amendments, the SEC stated that "it may be appropriate in some circumstances . . . for a proxy voting advice business to disclose its practice of selectively consulting with certain clients before issuing its benchmark voting recommendation on a specific matter" due to a concern that such practices "could allow for those consulted clients' voting preferences to influence recommendations given to other clients that were not consulted and importantly, without the knowledge of those clients not consulted."[4] The SEC also remarked in a separate footnote that the reported practice of investors using proxy voting advice businesses "as a vehicle for the purpose of coordinating their voting decisions" may result in the formation of a "group" and raises Section 13(d) and Section 13(g) compliance concerns under beneficial ownership reporting requirements.[5]

SUPPLEMENTAL INVESTMENT ADVISER GUIDANCE

The SEC also issued a supplement to its August 2019 guidance (the "Supplemental Guidance") to "assist investment advisers in fulfilling their proxy voting responsibilities in light of [the Amendments]."[6] In issuing the Supplemental Guidance, the SEC emphasized the need for consideration of registrant responses to proxy voting advice. Specifically, the Supplemental Guidance, which follows a question and answer format similar to the SEC's August 2019 guidance, notes that investment advisers should consider whether their

policies and procedures address circumstances in which they become aware that a registrant intends to file or has filed additional soliciting materials after they have received a recommendation from a proxy voting advice business, but before the proxy submission deadline, consistent with the new notice procedures outlined under the Amendments. If a registrant files additional information with sufficient lead time and that information would reasonably be expected to affect an investment adviser's voting determination, the Supplemental Guidance notes that the investment adviser would likely need to consider such information prior to voting in order to demonstrate that it is voting in its clients' best interest.

The Supplemental Guidance also provides that, in light of its duty of loyalty to clients to make full and fair disclosure of all material facts relating to the advisory relationship, an investment adviser who uses a proxy voting advice business's automated voting features should consider disclosing: (1) the extent to which and under what circumstances it uses such automated voting and (2) how the adviser's policies and procedures address the use of automated voting when it receives notice that an issuer has filed or intends to file additional soliciting materials. The Supplemental Guidance states the SEC's view that these disclosures may be necessary for an investment adviser's clients to be able to provide informed consent to the use of automated voting in a manner that is consistent with the investment adviser's duty of loyalty.

STATEMENTS FROM SEC COMMISSIONERS

In his public statement supporting the Amendments and Supplemental Guidance, Chairman Clayton remarked that, due to the significant influence proxy voting advice businesses have on the voting determinations of mutual funds, exchange-traded funds and other investment advisers that make voting decisions on behalf of "Main Street" investors, it is important that the investment advisers have "access to transparent, accurate and materially complete information" and use proxy voting advice in a manner consistent with their fiduciary obligations.[7] Commissioner Roisman also expressed his belief that the Amendments and Supplemental Guidance would facilitate more informed voting by investment advisers, highlighting the goals of providing "consistent standards for conflict of interest disclosure as well as engagement with registrants." Commissioner Peirce also issued a statement in support of the Amendments and the Supplemental Guidance, which she views as clarifying the obligations of investment advisers and proxy voting advice businesses while giving these businesses flexibility, stating that proxy voting advice businesses "should not feel tethered to the safe harbors when developing their policies and procedures."

Commissioner Lee voted in opposition to both the Amendments and the Supplemental Guidance. In her public statement, she expressed concern that these changes allow for too much involvement from registrants in the proxy advisory process. She also noted that there was significant opposition to the new rules from the investors they were supposed to benefit.

FUTURE PROXY REFORMS

The Commissioners also made comments during the July 22 open meeting and in their public statements regarding the Amendments and Supplemental Guidance that indicate that additional proxy rules may be forthcoming. Chairman Clayton noted that other proxy reform topics such as efforts to address "proxy plumbing" and the "universal proxy" remain on the SEC's short-term agenda. In addition, Commissioner Roisman stated that he was "skeptical" that heavy reliance on automated voting features was consistent with the fiduciary obligations of investment advisors and that he believes the SEC should "pursue examinations of investment advisers' voting practices," including the automation of voting processes.

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ENDNOTES

1 Release Nos. IA-5325; IC-33605, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, *available at* https://www.sec.gov/rules/interp/2019/ia-5325.pdf.

2 Commissioner Lee's dissent is available at https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22.

3 For a summary of the SEC's August 2019 guidance and the initial proposed amendments, see our previous memoranda entitled "SEC Takes First Step on Proxy Reform" dated August 26, 2019 and "SEC Proposes Amendments to Proxy Solicitation and Shareholder Proposal Rules" dated November 14, 2019.

4 Release No. 34-89372, Exemptions from the Proxy Rules for Proxy Voting Advice, fn. 216, *available at* https://www.sec.gov/rules/final/2020/34-89372.pdf.

5 *Ibid.*, fn. 59.

6 Release No. IA-5547, Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, *available at* https://www.sec.gov/rules/policy/2020/ia-5547.pdf.

7 Chairman Clayton's public statement is available at https://www.sec.gov/news/public-statement/clayton-open-meeting-2020-07-22#_ftnref1.

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