

# Legal Update

## SEC Issues Guidance on the Application of the Proxy Rules to Voting Advice

With the increased concentration of share ownership by institutional investors over the past several decades, the influence of proxy advisory firms on shareholder votes has grown dramatically, all while the proxy regulatory process has become more complex. As noted by Chairman Jay Clayton of the US Securities and Exchange Commission (SEC), "Commission rule changes, state law changes, corporate governance practices, technology and other factors have all increased the significance of shareholder voting in our public capital markets."<sup>1</sup>

With this in mind, the SEC issued two interpretive releases on August 21, 2019. This Legal Update focuses on the SEC's release that provided guidance regarding the applicability of certain rules promulgated under Section 14 of the Securities Exchange Act of 1934 (Exchange Act) to proxy voting advice (Proxy Voting Advice Guidance).<sup>2</sup>

The SEC has been considering issues surrounding proxy advisory firms and the proxy voting process for years. For example, it issued a concept release in 2010 on the US Proxy System, often referred to as the "proxy plumbing" release, which, among other topics, addressed the role and legal status of proxy advisory firms and potential regulatory

responses.<sup>3</sup> The SEC staff held a roundtable on the use of proxy advisory firms in 2013 and issued Staff Legal Bulletin No. 20 in 2014 providing guidance with respect to the availability and requirements of two federal proxy rule exemptions that proxy advisory firms may seek to rely on. In November 2018, staff hosted a roundtable on the proxy process, with one of the three panels devoted to a discussion of proxy advisory firms. To facilitate discussion at the roundtable, the staff of the Division of Investment Management withdrew two no-action letters addressing investment advisers' use of recommendations of independent third parties to vote client proxies that were previously issued to Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (Sept. 15, 2004).<sup>4</sup> The SEC issued the current guidance after considering the viewpoints of various constituencies.

The SEC also issued guidance on the proxy voting responsibilities of investment advisers under the Investment Advisers Act of 1940 (Investment Adviser Guidance).<sup>5</sup> The Investment Adviser Guidance clarifies how an investment adviser's fiduciary duty relates to an adviser's proxy voting on behalf of clients, particularly if the investment adviser retains a

proxy advisory firm. The Investment Adviser Guidance is the subject of a separate Mayer Brown Legal Update.

The Proxy Voting Advice Guidance and the Investment Adviser Guidance will become effective upon publication in the *Federal Register*.

## Proxy Voting Advice Guidance

The SEC addressed two distinct issues in its Proxy Voting Advice Guidance. First, the SEC explained that proxy voting advice provided by a proxy advisory firm generally constitutes a solicitation under the federal proxy rules. Second, the SEC clarified that Rule 14a-9 under the Exchange Act, which prohibits solicitations from containing false or misleading statements or omissions of a material fact, applies to proxy voting advice.

**Proxy Voting Advice as Solicitation.** Rule 14a-1(l) under the Exchange Act defines solicitation broadly to include a “communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.” In the Proxy Voting Advice Guidance, the SEC articulated its view that proxy voting advice “provided by a firm marketing its expertise in researching and analyzing proxy issues for purposes of helping its clients make proxy voting determinations (i.e., not merely performing administrative or ministerial services) should be considered a solicitation subject to the federal proxy rules.” According to the Proxy Voting Advice Guidance, this is the case even if the proxy advisory firm makes recommendations based on application of its client’s own tailored voting guidelines and even in circumstances where its client may not follow the advice provided.

The SEC distinguished proxy voting advice provided by proxy advisory firms from “unsolicited” voting advice that a broker might

give when responding to a customer inquiry because proxy advisory firms are not “merely responding to client inquiries.” Rather, “the communication is invited by the proxy advisory firms themselves through the marketing of their expertise in researching and analyzing proxy issues for purposes of helping clients make proxy voting determinations.”

Although proxy voting advice from a proxy advisory firm constitutes a solicitation, proxy advisory firms may avail themselves of exemptions from the information and filing requirements of the federal proxy rules to the extent they satisfy the terms of an applicable exemption.

**Applicability of Rule 14a-9 to Proxy Voting Advice.** The antifraud prohibitions of Rule 14a-9 apply to solicitations, regardless of whether the solicitations are exempt from the information and filing requirements of the federal proxy rules. Therefore, Rule 14a-9 applies to proxy voting advice and this advice may not contain materially false or misleading statements or omit material facts that would be required to make the advice not misleading. This prohibition covers “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.”

The Proxy Voting Advice Guidance provided three examples of types of information that a proxy advisory firm may need to disclose to avoid a potential violation of Rule 14a-9:

- “an explanation of the methodology used to formulate its voting advice on a particular matter (including any material deviations from the provider’s publicly-announced guidelines, policies, or standard methodologies for analyzing such matters) where the omission of such information would render the voting advice materially false or misleading,”

- “to the extent that the proxy voting advice is based on information other than the registrant’s public disclosures, such as third-party information sources, disclosure about these information sources and the extent to which the information from these sources differs from the public disclosures provided by the registrant if such differences are material and the failure to disclose the differences would render the voting advice false or misleading,” and
- “disclosure about material conflicts of interest that arise in connection with providing the proxy voting advice in reasonably sufficient detail so that the client can assess the relevance of those conflicts.”

## Practical Considerations

By issuing proxy voting guidance approved at the commission level (as opposed to staff guidance), the SEC has made a strong statement that it considers voting a significant attribute of share ownership and shareholder engagement. Proxy advisory firms, investment advisers, public companies and other parties involved in the proxy voting process should review the guidance carefully and consider seriously the advice it offers.

As guidance and interpretations of existing requirements, both the Proxy Voting Advice Guidance and the Investment Adviser Guidance apply to the upcoming proxy season. Therefore, proxy advisory firms and investment advisers should immediately begin assessment of what impact the SEC’s examples, suggestions and interpretations will have on their proxy voting activities. And, because the guidance may affect proxy voting at annual meetings, public companies should monitor developments in this area.

While the Proxy Voting Advice Guidance does not change existing regulations, the SEC has indicated that it is considering proposals that would involve related changes to the federal

proxy rules. Specifically, the SEC expects to propose rules to amend the submission and resubmission thresholds for shareholder proposals under Rule 14a-8 and to propose amendments to address proxy advisory firms’ reliance on the proxy solicitation exemptions in Rule 14a-2(b). Those interested in the proxy process should watch for these SEC proxy-related proposals.

In addition, because the Proxy Voting Advice Guidance discusses prior SEC interpretations and case law regarding what constitutes a solicitation, it is a resource for anyone interested in an analysis of what constitutes solicitation.

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## Endnotes

<sup>1</sup> <https://www.sec.gov/news/public-statement/statement-clayton-082119>.

<sup>2</sup> <https://www.sec.gov/rules/interp/2019/34-86721.pdf>.

<sup>3</sup> <https://www.sec.gov/rules/concept/2010/34-62495.pdf>.

<sup>4</sup> <https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters>.

<sup>5</sup> <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>.

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