

Legal Update

SEC Proposes Proxy Voting Advice Rule Amendments

On November 5, 2019, the US Securities and Exchange Commission (SEC) proposed amendments (the "Proposal") to proxy solicitation rules that are designed to enhance the accuracy and transparency of the information that proxy advisory firms, such as Institutional Shareholder Services Inc. (ISS) and Glass Lewis, provide to investors and others who vote on behalf of investors.¹

The Proposal would add conditions to the exemptions from the information and filing requirements of the proxy solicitation rules that proxy advisory firms currently rely on. In addition, it would codify recent SEC guidance regarding when the provision of proxy voting advice constitutes a solicitation for the purposes of the proxy rules. The Proposal would also provide examples to clarify when failure to disclose certain information in the proxy voting advice could be considered misleading.

Comments on the Proposal are due 60 days after publication in the *Federal Register*. The Proposal contemplates a one-year transition period after final amendments are adopted.

Background

The Proposal results from the SEC's examination of issues surrounding proxy advisory firms and the proxy voting process over the course of many years, during which time the SEC had the

opportunity to consider viewpoints representing various constituencies. For example, the SEC 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.² Then in 2013, the SEC staff held a roundtable on the use of proxy advisory firms, which was followed by 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, the SEC staff hosted another 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. (September 15, 2004).³

On August 21, 2019, the SEC issued an interpretive release providing guidance on how the current proxy rules apply to proxy voting advice (Proxy Voting Advice Guidance), which became effective upon its publication in the *Federal Register* on September 10, 2019.⁴

For more information on the Proxy Voting Advice Guidance, see our Legal Update “SEC Issues Guidance on the Application of the Proxy Rules to Voting Advice,” dated August 27, 2019.⁵ Thereafter, on October 31, 2019, ISS sued the SEC in the US District Court for the District of Columbia, asserting that the Proxy Voting Advice Guidance was unlawful and seeking declaratory and injunctive relief. However, the Proxy Voting Advice Guidance remains in effect at this time.

Proposed Amendments to Proxy Solicitation Exemptions

Rule 14a-2(b) under the Securities Exchange Act of 1934 provides exemptions from the information and filing requirements of the SEC’s proxy solicitation rules. (These exemptions do not exempt proxy solicitations from the antifraud requirements of Rule 14a-9, as discussed below.)

Proxy advisory firms typically rely on one or both of the following two exemptions:

- Rule 14a-2(b)(1), which generally exempts solicitations by persons who do not seek the power to act as proxy and do not have a substantial interest in the subject matter of the communication beyond their interest as shareholders.
- Rule 14a-2(b)(3), which generally exempts proxy voting advice furnished by an advisor to any other person with whom the advisor has a business relationship.

The Proposal would add two new conditions to these exemptions applicable to persons furnishing proxy voting advice that constitutes a solicitation.

Proposed Conflict of Interest Disclosure Condition. New Rule 14a-2(b)(9)(i) would add conflict of interest disclosure conditions to the availability of the Rule 14a-2(b)(1) and Rule 14a-2(b)(3) exemptions for proxy advisory firms. This proposed amendment would

require proxy voting advice, and any electronic medium used to deliver it, to contain prominent disclosure of:

- Any material interests, direct or indirect, of the proxy voting advice business (or its affiliates) in the matter or parties concerning which it is providing the advice;
- Any material transaction or relationship between the proxy voting advice business (or its affiliates) and the registrant, another soliciting person, shareholder proponent, or affiliates of any of the foregoing (as determined using publicly available information) connected with the matter covered by the proxy voting advice;
- Any other information regarding the 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.

According to the proposing release, it would not be sufficient to provide conflict of interest disclosures upon request; they would have to be included in the proxy voting advice report. These conflict of interest disclosures have to be “sufficiently detailed so that clients of proxy voting advice businesses can understand the nature and scope of the interest, transaction, or relationship to appropriately assess the objectivity and reliability of the proxy voting advice they receive.” Among other things, this disclosure, depending on the circumstances, could require the approximate dollar amount involved when necessary for the client of the proxy advisory firm to adequately assess the potential effects of the conflict of interest. The proposing release expressly advised that

“[b]oilerplate language that such relationships or interests may or may not exist would be insufficient for purposes of satisfying this condition to the exemptions.”

Proposed Advanced Review Condition. New Rule 14a-2(b)(9)(ii) would establish review procedures as a condition to the availability of the Rule 14a-2(b)(1) and Rule 14a-2(b)(3) exemptions for proxy advisory firms. Specifically, the proxy advisory firm would have to give companies—regardless of size—an advance copy of the report it intends to deliver to its clients, for the company’s review and feedback, before the advice is issued, as long as the company files its definitive proxy materials at least 25 days before its meeting. The time period for company review and feedback would be five business days if the filing occurs at least 45 days before the meeting. Otherwise it would be three business days. Proxy advisory firms would not have to make changes based on company feedback, but, as discussed below, their reports would be subject to the Rule 14a-9 prohibition on materially false or misleading statements or omissions.

After the review and feedback period, the proxy advisory firm would have to give its final voting advice report to the company no later than two business days before it is issued to investors. This would give the company the opportunity to prepare a written statement of its views on the voting recommendations. Upon the request of the company, the proxy advisory firm would have to include a link to the company’s statement in its voting advice report and any electronic medium used to deliver the advice. Companies would need to file any such statement with the SEC as additional definitive solicitation materials.

If a company files its definitive proxy materials less than 25 days before its meeting, it would not be entitled to review and provide feedback on the proxy voting advice report in advance of its release, to receive a copy of the final proxy voting advice report before it is

released or to require the proxy advisory firm to include a link in its proxy voting advice report to the company’s written response.

The same review procedures for companies would apply to other soliciting persons involved in non-exempt solicitations, such as a proxy fight. However, the review opportunity is not required to be provided to proponents of shareholder proposals that are included in a company’s proxy statement.

Under the Proposal, proxy advisory firms would be able to require that companies and other soliciting persons enter into confidentiality agreements as a condition of receiving advance copies of the voting advice. Such agreements could be no more restrictive than the types of confidentiality agreements that proxy advisory firms require of other recipients of their proxy voting advice. The confidentiality period could not extend beyond the release of the voting advice.

Proposed Amendment to Definition of Solicitation

The Proposal would codify the SEC’s recent Proxy Voting Advice Guidance on proxy voting advice constituting a solicitation for purposes of the proxy solicitation rules. Specifically, the Proposal would expand the definition of solicitation contained in Rule 14a-1(l)(iii) to provide that the terms “solicit” and “solicitation” include:

The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy, including:

(A) Any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a

provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.

The Proposal also would expressly carve out from the definition of solicitation “the furnishing of any proxy voting advice by a person who furnishes such advice only in response to an unprompted request.”

Proposed Amendment to Antifraud Provision

Rule 14a-9 prohibits materially false or misleading statements or omissions in proxy 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 that is a solicitation. Rule 14a-9 currently provides some examples of what, depending on facts and circumstances, may be misleading for this purpose. The Proposal would add the following example to this list, consistent with the Proxy Voting Advice Guidance:

Failure to disclose material information regarding proxy voting advice covered by §240.14a-1(l)(1)(iii)(A), such as the proxy voting advice business’s methodology, sources of information, conflicts of interest or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves.

As an illustration, the proposing release discussed concerns that arise when a proxy advisory firm makes a negative voting recommendation based on its own evaluation of the adequacy of a company’s conduct or disclosure without disclosing that the company has complied with applicable SEC requirements and without conveying the material differences between the SEC’s requirements and the proxy advisory firm’s own standards. As explained in the proposing release, if a proxy advisory firm, using its own independence standards,

recommends against election of a director who serves on an audit committee, the proxy advisory firm may need to clarify that it applied a standard that is different from the SEC’s standard in order to prevent that recommendation from being misleading.

Practical Considerations

The Proxy Voting Advice Guidance is currently in effect. The Proposal, on the other hand, is subject to comment for 60 days following publication in the *Federal Register* and then to the time it takes for the SEC to consider the comments and develop a final rule before any amendments can be adopted. In addition, the Proposal contemplates a one-year transition period following the adoption of final rules. Given these time constraints, the Proposal will not directly impact the 2020 proxy season.

Over the years, various concerns have been raised regarding proxy voting advice. Now that the Proposal has been issued, it seems likely that there will be a great deal of scrutiny, from differing perspectives, on the impact of the specific amendments now being considered. The SEC welcomes input on the Proposal. The Proposal contains 60 requests for comment on various aspects of the suggested amendments, many of which contain multiple questions. Commissioner Elad Roisman, who took a leadership role on the Proposal, described it as “a *first step* toward receiving actionable feedback that can help us move toward a sensible modernization of our rules” (emphasis in original).⁶ Public company perspectives are relevant to this discussion and would be useful in the debate over the direction of proxy solicitation rules impacting proxy voting advice. Companies that have opinions about how the Proposal addresses the provision of proxy voting advice should consider joining the conversation by submitting comments to the SEC.

For more information about the topics raised in this Legal Update, please contact the author Laura D. Richman, any of the following lawyers or any other member of our Corporate & Securities practice.

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Endnotes

- ¹ <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.
- ² <https://www.sec.gov/rules/concept/2010/34-62495.pdf>.
- ³ <https://www.sec.gov/news/public-statement/statement-regarding-staff-proxy-advisory-letters>.
- ⁴ <https://www.sec.gov/rules/interp/2019/34-86721.pdf>.
- ⁵ <https://www.mayerbrown.com/-/media/files/perspectives-events/publications/2019/08/secissuesguidanceontheapplication.pdf>.
- ⁶ <https://www.sec.gov/news/public-statement/statement-roisman-2019-11-05-14a-2b>.

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