

Client Alert

SEC Issues Final Rules Impacting Proxy Advisors

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On July 22, 2020, the SEC met and adopted final rules which will impact proxy advisors¹ (known in SEC-speak as “proxy voting advice businesses”), such as Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. (Glass Lewis).

Overall, the final rules impose new process requirements and costs, but likely do not dramatically change the existing power wielded by firms like ISS and Glass Lewis, primarily because the final rules are not particularly onerous. They are unlikely to satisfy corporate America, which was hoping for more substantive regulation of the proxy voting advice businesses. It is important to note that more large institutional shareholders are implementing their own proxy voting offices and are less likely to have their votes tied to recommendations of these firms. Over time, this may lessen the power wielded by proxy voting advice businesses, while also presenting new challenges for companies facing an array of inconsistent voting policies adopted by institutional shareholders.

Proxy Advisor Rule Changes

The SEC rules are largely targeted at the processes by which the dominant proxy advisory firms (e.g., ISS and Glass Lewis) provide voting guidance on proxy proposals. The current approaches by these firms have been criticized as lacking transparency and being potentially influenced by conflicts of interest.

Under the final rules:

- The SEC codified the definition of “solicitation” it issued in its guidance back in August 2019, i.e., that solicitation includes providing vote recommendations.
 - This will cause proxy advisors to be subject to the information and filing requirements of the SEC’s proxy rules unless they qualify for the exemption discussed below.
- The SEC modified the anti-fraud provision to provide that the failure of proxy voting advice businesses to disclose material information such as methodology, sources of information, or conflicts of interest could be considered misleading, and thus subject to the anti-fraud provision.

¹ See SEC Press Release, 2020-161, *SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information* (July 22, 2020), available at: <https://www.sec.gov/news/press-release/2020-161>; and SEC Release No. 34-89372; File No. S7-22-19, available at: <https://www.sec.gov/rules/final/2020/34-89372.pdf>.

- Proxy advisors may rely on the Exchange Act Rule 14-a2(b) exemption/“safe harbor” from the information and filing requirements of the proxy rules by complying with the following conditions:
 - They must include disclosure of material conflicts of interest in their proxy voting advice or in an electronic medium used to deliver the proxy voting advice.
 - The SEC declined to provide a prescriptive disclosure requirement; rather, it adopted a rule requiring proxy voting advice businesses to base their conflicts of interest disclosures on assessments of materiality.
 - They must adopt and publicly disclose written policies and procedures reasonably designed to ensure that:
 - Public companies that are the subject of proxy voting advice have such advice made available to them at or prior to the time when such advice is disseminated to the proxy voting advice business’s clients;
 - The proxy voting advice business provides 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 the company, in a timely manner before the security holder meeting; and
 - The SEC provided a non-exclusive safe harbor that provides proxy voting advice businesses with assurance that they have satisfied the written policies and procedures requirements. Basically, the proxy voting advice business must provide companies a copy of its proxy voting advice at no charge, which may be subject to some conditions. For example, a company must file their definitive proxy statement at least 40 calendar days before the date of the shareholder meeting and acknowledge that the proxy voting advice will only be used internally.

These requirements have been modified from those the SEC proposed back in November 2019.² Significantly, the final rules forgo the feedback and review of the proxy voting advice by a public company prior to the advice being sent to the proxy voting advice business’s clients. Instead, the final rules focus on timely informing public companies about proxy voting advice and then requiring the proxy voting advice business to have a mechanism in place so that its clients may be informed on a timely basis about any statements made by the public company about such proxy voting advice.

Effective Date

The final rule amendment becomes effective 60 days after publication in the *Federal Register*. However, the proxy voting advice businesses are not required to comply until December 1, 2021, so the rules will not apply to the 2021 proxy season. Eventual compliance may also depend on whether the SEC receives any challenges to this rulemaking similar to the lawsuit ISS filed against the SEC for its August 2019 advice, where ISS argued that providing proxy voting advice is not a solicitation.

² See SEC Press Release, 2019-231, *SEC Proposes Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice* (November 5, 2019), available at: <https://www.sec.gov/news/press-release/2019-231>; and SEC Release No. 34-87457; File No. S7-22-19, available at: <https://www.sec.gov/rules/proposed/2019/34-87457.pdf>.



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