

Client Alert

SEC Proposes Changes to Rules Impacting Proxy Advisors and Shareholder Proposals

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Management Advisors

On November 5, 2019, the SEC met and issued two sets of proposed changes to existing rules. One impacts proxy advisors¹ (known in SEC-speak as “proxy voting advice businesses”), such as Institutional Shareholder Services, Inc. (ISS) and Glass, Lewis & Co. (Glass Lewis), and the other proposed rule impacts the requirements for shareholders to submit proposals.²

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 proposed proxy advisor rule changes:

- The SEC would codify the definition of “solicitation” it issued in its guidance back in August 2019, i.e., that solicitation includes providing vote recommendations.³
- Proxy advisors relying on the Exchange Act Rule 14-a2(b) exemption from the information and filing requirements of the proxy rules would be subject to the following conditions:
 - They must include disclosure of material conflicts of interest in their proxy voting advice;
 - Public companies must be given an opportunity to review and provide feedback on proxy voting advice before it is issued; and
 - Public companies may request that proxy advisors include in their proxy voting reports a hyperlink or similar electronic communication indicator that directs the recipient of the proxy voting report to a written statement that sets forth the public company’s views on the proxy voting report.

¹ See SEC Press Release, 2019-231, *SEC Proposed Rule Amendment 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>.

² See SEC Press Release, 2019-232, *SEC Proposes Amendments to Modernize Shareholder Proposal Rule* (November 5, 2019), available at: <https://www.sec.gov/news/press-release/2019-232>; and SEC Release No. 34-87458; File No. S7-23-19, available at: <https://www.sec.gov/rules/proposed/2019/34-87458.pdf>.

³ SEC Release No. 34-86721, *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice*, available at: <https://www.sec.gov/rules/interp/2019/34-86721.pdf>.

However, the proposed rule amendments would permit proxy advisors to require public companies to enter into confidentiality agreements for materials exchanged during the review and feedback period. Additionally, proxy advisors could rely on the exemptions where failure to comply with the new conditions was immaterial or unintentional.

Overall, the proposed rules would impose new process requirements, likely costs, and potential liability exposure on proxy advisory firms, but would likely not dramatically change the existing power wielded by firms like ISS and Glass Lewis. However, as more large institutional shareholders implement their own proxy voting offices, they are less likely to have their votes tied to recommendations of such firms.

Shareholder Proposals

The proposed changes to the shareholder proposal rules would generally “modernize” the rules according to the SEC.

The proposed amendments would:

- Update the criteria, including the ownership requirements, that a shareholder must satisfy to be eligible to have a shareholder proposal included in a company’s proxy statement.

The changes to the ownership requirements are as follows:

— Current requirement: \$2,000 or 1% of a company’s securities held for at least one year.

— Proposed requirements:

- If held for at least one year: \$25,000;
- If held for at least two years: \$15,000; and
- If held for at least three years: \$2,000.

Determination as to whether a proponent meets the above thresholds for value of securities held would be made by looking to see if on any day within 60 calendar days prior to the submission of a proposal, the shareholder’s investment is valued at or above the relevant threshold using the average of the bid and ask prices.

- Update the “one proposal” rule to clarify that a single person may not submit multiple proposals at the same shareholders’ meeting, whether the person submits a proposal as a shareholder or as a representative of a shareholder or group of shareholders.
- Modernize the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company’s future shareholder meetings.

The proposed changes to the resubmission thresholds are also markedly different from current requirements and introduce an override provision:

— Current resubmission thresholds: 3%, 6%, and 10% for matters voted on once, twice, or three or more times, respectively, in the last five years.

— Proposed resubmission thresholds: 5%, 15%, and 25% for matters voted on once, twice, or three or more times, respectively, in the last five years.

- Override Provision: However, if a proposal has been previously voted on three or more times in the last five years, it can be excluded if: (1) it received less than 50% of votes cast, and (2) experienced a decline in shareholder support of 10% or more compared to the immediately preceding vote.

Comment Periods

Both sets of proposed rule amendments have a 60-day public comment period. Therefore, it is unlikely that these rules could be finalized and apply to the 2020 proxy season, but if finalized and no new challenges are brought against these proposed rules (such as the lawsuit ISS recently filed against the SEC for its August 2019 advice regarding the applicability of the proxy rules to proxy voting advice), it could be beyond the 2021 proxy season before we have final rules that impact the market.

Consequently, there is not much that public companies should do at this point except perhaps provide comments with respect to these rule proposals within the next 60 days to the SEC.



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