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SEC Adopts Final Rules on Proxy Voting Advice and Related Guidance on Investment Adviser Voting Responsibilities

The Securities and Exchange Commission recently adopted amendments (the "**Amendments**") to its proxy solicitation rules in regards to proxy voting advice. Among other things, the Amendments:

- codify the SEC's longstanding view that proxy voting advice constitutes a solicitation under the proxy rules;
- clarify that a failure to provide material information (such as a proxy advisory firm's methodology, sources of information or conflicts of interest) would violate the antifraud provisions of the proxy rules; and
- require proxy advisory firms, subject to limited exceptions and conditions, to institute reasonable procedures to (i) provide companies with a copy of their initial voting advice at the same time or before dissemination to their clients and (ii) alert clients to written responses to the proxy voting advice by the subject companies.

Concurrently with the Amendments, the SEC also supplemented its prior guidance regarding the proxy voting responsibilities of investment advisers, with additional clarification on how investment advisers should (i) consider company responses to proxy voting advice under the Amendments and (ii) act in a client's best interest when utilizing a proxy advisory firm's electronic vote management system.

The Amendments are effective December 1, 2021, while the supplemental guidance became effective upon publication in the *Federal Register* on September 3, 2020. We note that ISS has reinstated its lawsuit seeking to vacate these changes. See here.

Background

In recognition of the increasing importance of proxy advisory firms in the corporate voting process, the SEC proposed amendments to the federal proxy rules in November 2019 to enhance the transparency and accuracy of the information provided by such firms to clients in connection with their voting decisions. Following public comment, the SEC adopted the Amendments on July 22, 2020, with changes which generally apply a less prescriptive, more "principles-based" approach than had been proposed. While the Amendments provide two key safe harbors for complying with new disclosure and procedural requirements (as discussed in more detail below), the adopting release stresses that the safe harbors are not exclusive and that proxy advisory firms have discretion in how they comply.

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Amendments to Section 14 of the Exchange Act

Codification of Proxy Voting Advice as "Solicitations" under Rule 14a-1(l). The Amendments codify the existing SEC view that a "solicitation," as defined in Exchange Act Rule 14a-1(l), includes proxy voting advice. The SEC reiterated that the definition of solicitation is "broad" and includes a "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy." In keeping with this view, the Amendments clarify Rule 14a-1(l) by adding that the terms "solicit" and "solicitation" include any "proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder 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."

Each set of voting recommendations by a firm under different voting policies constitutes separate communications of proxy voting advice and each is subject to the proxy rules. However, any proxy voting advice given in response to an unprompted request (such as a financial advisor or broker who has received unsolicited inquiries from its clients on how to vote their shares) would not be considered a "solicitation."

New Conditions for Exemptions from Proxy Information and Filing Requirements under Rule 14a-2(b) for Proxy Advisory Firms. Notwithstanding that proxy voting advice is a solicitation, proxy advisory firms may still rely on exemptions from certain of the SEC's proxy solicitation information and filing requirements so long as they:

- do not seek, directly or indirectly, the power to act as a proxy for a shareholder and do not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization; and

- satisfy new conditions relating to (i) conflicts of interest disclosure, (ii) making proxy voting advice available to companies at, or prior to, the time when such advice is disseminated to clients and (iii) mechanisms to ensure that clients are made aware in a timely fashion of any written response by a company to proxy voting advice, in each case as described in more detail below. Proxy voting advice need not comply with these conditions to benefit from the exemption if such advice is (a) based on so-called "custom policies" that are proprietary to a proxy advisory firm's client or (b) given in a solicitation that complies with the SEC's requirements to provide proxy materials under Rule 14a-3(a) and involves approval of a business combination under Rule 145(a) or certain contested matters.

Conflicts of Interest Disclosure. To be able to rely on the Rule 14a-2(b) exemptions, proxy advisory firms will have to include in their advice (including in any electronic medium used to deliver the advice) "prominent disclosure" of the following:

- any information regarding an interest, transaction or relationship of the proxy advisory firm or its affiliates that is material to assessing the objectivity of the proxy voting advice in light of the particular interest, transaction or relationship; and

- any policies and procedures to identify, and the steps taken to address, any such material conflicts of interest arising from the interest, transaction or relationship.

The SEC opted against more prescriptive conflicts disclosure requirements that some commenters had advocated (*e.g.*, setting specific monetary disclosure thresholds), in favor of a principles-based rule that is meant to account for a variety of circumstances that could materially impact a firm's objectivity. The Amendments allow proxy advisory firms to apply their judgment in determining the materiality of any conflicts that could affect their objectivity, but the adopting release offered several examples of where material conflicts may exist for proxy advisory firms, such as:

- providing voting advice to clients on a company's proposals where the firm earns fees (or seeks to earn fees) from that company for corporate governance and executive compensation advisory services;

- providing voting advice on a matter in which the firm's affiliates or another client has a material interest; or

- providing voting advice on a company's proposals where the firm's affiliates hold a significant ownership interest in the company, sit on the company's board of directors or have relationships with a shareholder presenting a proposal.

The SEC notes that the conflicts disclosures should be detailed enough so that clients can understand the nature and scope of the interest, transaction or relationship and assess the objectivity and reliability of the advice they receive, which may include the identities of the parties or affiliates and the approximate dollar amount of fees involved in the interest, transaction or relationship. The SEC warns that boilerplate language that such interests may or may not exist would be insufficient.

Making Proxy Voting Advice Available to Companies. The Amendments mandate that proxy advisory firms adopt and publicly disclose written policies and procedures reasonably designed to ensure that proxy voting advice is made available to the subject companies at, or prior to, the time when such advice is disseminated to the proxy advisory firm's clients. The proposed amendments had established a mandatory vetting process for companies to review and give feedback on proxy voting advice prior to distribution to the proxy advisory firm clients; however, such requirements were eliminated in favor of this more "principles-based approach" in the final Amendments.

While proxy advisory firms are free to adopt their own mechanisms to satisfy the foregoing requirements, the Amendments provide a non-exclusive safe harbor for compliance. A proxy advisory firm will be deemed to satisfy the above requirement if its written policies and procedures are reasonably designed to provide companies with a copy of its proxy voting advice, at no charge, no later than the time it is disseminated to the firm's clients. The safe harbor specifies that a proxy advisory firm may condition access to its voting advice on a company (i) filing its definitive proxy statement at least 40 days before the shareholder meeting and (ii) expressly acknowledging that it will only use the proxy voting advice for internal purposes and will not share such advice except with employees or advisers. The SEC acknowledges that it does not have an estimate of the financial cost to proxy advisory firms of providing their voting advice to all relevant companies. In addition, questions remain over certain ambiguities in the safe harbor requirements. For example, what constitutes a "copy" of a firm's proxy voting advice – the full detailed voting report, or only the firm's voting recommendations?

Alerting Clients to Company Responses to Proxy Voting Advice. The Amendments also require that proxy advisory firms adopt and publicly disclose written policies and procedures reasonably designed to ensure that they provide their clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding proxy voting advice by companies who are the subject of such advice, in a timely manner before the shareholder meeting. Similarly, the Amendments provide a non-exclusive safe harbor by which proxy advisory firms would be deemed to satisfy this requirement if their written policies and procedures are reasonably designed to provide notice on their electronic client platform or through other electronic means (such as by email) that a company has filed, or has informed the proxy advisory firm that it intends to file, additional materials setting forth the company's response to the proxy voting advice (and include an active hyperlink to those materials on EDGAR when available).

Expansion of Examples of Potentially Misleading Information under Rule 14a-9. One important aspect of the Amendments is that even though proxy advisory firms will be exempt from certain of the SEC's proxy information and filing rules, their voting advice as solicitations will be subject to Rule 14a-9's antifraud provisions. Further, the Amendments add a new section (e) to the note for Rule 14a-9, which states that failure to disclose "material information" with respect to proxy voting advice could be materially misleading within the meaning of the rule. The types of information that may be material include the proxy advisory firm's methodology, sources of information or conflicts of interest.

Supplemental Guidance Regarding Proxy Voting Responsibilities of Investment Advisers

The SEC issued guidance in 2019 discussing how an investment advisor could use proxy voting advice in exercising voting authority on behalf of clients and also provided examples to help facilitate investment advisers' compliance with their obligations in connection with proxy voting (see our client alert here). The SEC has now issued supplemental guidance in light of the Amendments, which focuses on the common practice among investment advisers of relying on proxy advisory firms (i) to populate each vote

on their electronic voting platform with the firm's recommendations based on client voting instructions ("pre-population") and/or (ii) to automatically submit client votes to be counted ("automated voting").

The guidance discusses steps that investment advisers may take to demonstrate that they are making voting determinations in their clients' best interests when using a proxy advisory firm to assist with voting mechanics. Specifically, investment advisers should assess any votes subject to pre-population and consider additional information that may become available before a vote. The guidance also states that investment advisers should consider whether their policies and procedures address circumstances where they become aware that a company intends to file or has filed additional soliciting materials with the SEC after they have received the proxy advisory firm's voting recommendation but before the submission deadline for proxies to be voted at a shareholder meeting.

Lastly, the guidance reminds investment advisers of their obligation to fully disclose to clients all material facts relating to their relationships with proxy advisory firms. Such disclosure should include material facts related to the exercise of voting authority with respect to client securities.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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