

SEC Proposes Rule Changes for Proxy Advisory Firms

Article By:

John S. Marten

Nathaniel Segal

Jacob C. Tiedt

On November 5, 2019, the SEC issued a release proposing amendments to the federal proxy rules that are intended to enhance the accuracy and transparency of information provided by proxy advisory firms to investors and investment advisers that vote proxies on behalf of their clients.

Rule 206(4)-6 under the Investment Advisers Act of 1940 requires registered investment advisers to adopt and implement policies and procedures reasonably designed to ensure that they vote proxies in the best interest of clients. Soon after Rule 206(4)-6 was adopted, the SEC staff issued two no-action letters—Egan-Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (Sept. 15, 2004)—indicating that advisers could demonstrate proxies were voted in their clients' best interest by voting proxies based on a recommendation of an independent third party, subject to certain conditions. In response, many advisers engaged an independent proxy advisory firm to provide voting advice and recommendations. These no action letters were rescinded by the SEC staff prior to a proxy roundtable held in November 2018, but the practical effects of this rescission were minimal because most advisers were able to continue to rely on SEC Staff Legal Bulletin No. 20, issued in 2014, which contained similar guidance. In August 2019, the SEC staff issued interpretive guidance regarding advisers' proxy voting responsibility, including the view that a voting recommendation given by a proxy advisory firm generally constitutes a "solicitation" that is subject to the federal proxy rules.¹

Following the SEC staff's August 2019 proxy voting guidance, the SEC proposed amendments to the proxy rules related to the use of proxy advisory firms in November 2019. These proposed amendments include the following:

- **Definition of Solicitation.** The proposed amendments would codify the SEC staff's interpretation that voting advice given by a proxy advisory firm constitutes a "solicitation" within the meaning of Rule 14a-1 under the Securities Exchange Act of 1934. The practical consequence of this interpretation would be that proxy advisory firms generally would become subject to the information and filing requirements in the federal proxy solicitation rules unless an exemption is available.

- **New Conditions for Reliance upon Proxy Solicitation Exemptions.** The proposed amendments would add two new conditions to the exemptions in Rule 14a 2 that are typically relied upon by proxy advisory firms.
 - **Conflict of Interest Disclosure.** To rely upon the exemptions, a proxy advisory firm would be required to prominently disclose any material conflicts of interest.
 - **Review by Registrant.** To rely upon the exemptions, a proxy advisory firm would be required to give the registrant whose shareholders are being asked to vote on a matter upon which the advisory firm has provided proxy voting advice an opportunity to review and provide feedback on that advice before the advice is delivered to clients. The purpose of this condition is to identify factual errors, incompleteness or methodological weaknesses in the advisory firm's analysis.
- **Antifraud Provisions.** The proposed amendments make it clear that proxy voting advice is subject to the antifraud provisions of Rule 14a 9 under the Exchange Act, which provides that a proxy solicitation may not contain a material misstatement or omission. To avoid a potential violation, a proxy advisory firm may need to disclose certain information, such as the methodology used to reach a recommendation, any third-party information used in its analysis and any material conflicts of interest. The proxy advisory firm would also be required to disclose any material differences between its use of standards that materially differ from standards or requirements established or approved by the SEC. For example, if a proxy advisory firm were to recommend against the election of a director on the basis of independence using proprietary standards developed by the proxy advisory firm, as opposed to the SEC's standards, it may be necessary for the advisory firm to state that its recommendation is based on independence standards that differ from those of the SEC.

The SEC's proposing release is available [here](#).

¹ For more information, see Vedder Price P.C.'s summary of the SEC staff's August 2019 proxy voting guidance, *SEC Issues Proxy Voting Guidance*, which is available [here](#).