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SEC's Proposed Rules on Proxy Advisory Firms Provoke Mixed Response

Last month, the Securities and Exchange Commission [announced](#) proposed [rules](#) regarding proxy advisors. SEC Chair Jay Clayton [compared](#) proxy advisory firms' effect on shareholder engagement and the capital markets to that of other significant third-party market participants such as auditors, rating agencies, and research analysts. He emphasized that—amid the myriad investor interests and preferences extant in the marketplace—there is a common need for information material to an investment decision. The proposed rules regarding proxy advisors are designed to help investors obtain relevant information of improved quality and value.

The proposed rules generally were received favorably by companies as well as other market participants who share the concern that proxy advisory firms wield undue influence in the proxy voting process. SEC Commissioner Robert Jackson [dissented](#) from the SEC's approval of the proposed rules, expressing the concern that the proposal “simply shields CEOs from accountability to investors.” There was swift criticism from other quarters: The Council of Institutional Investors released a [statement](#) the same day as the SEC's announcement, taking the view that the proposed rules would be detrimental to shareholder rights. CII objected to the regulation of proxy advisory firms as proxy solicitors and argued that the proposed rules “would pressure proxy advisory firms to take a more management-friendly approach in their reports and vote recommendations.” CII accused the SEC of bowing to “pressure from CEOs” who, with a “concerted effort by lobbyists,” are resisting shareholders' attempts to hold corporate executives accountable. Subsequently, CII has written to the SEC to request clarifications as to certain elements of the proposed rules and has also requested that the SEC extend the comment period from 60 to 120 days.

The SEC was well aware that its proposed rules would be met with resistance from the proxy advisory firms themselves. In late October, Institutional Shareholder Services filed [suit](#) against the SEC in federal district court in Washington, DC, challenging the application of proxy solicitation rules to the provision of proxy advice. The [interpretation and guidance](#) at issue (discussed [here](#)), which would be codified per the proposed rules, was released in August. ISS [claims](#) the proposal would “diminish investor protections” and “chill ISS' protected speech.” The outcome of this lawsuit may affect the SEC's ability to implement its proposed rules regarding the regulation of proxy advisory firms.

The key elements of the proposed rules are the following:

1. Proxy Solicitation Rules Apply to Proxy Advisors. The proposed rules would amend Rule 14a-1(l) to codify the interpretation and guidance released by the SEC in August 2019 that proxy advisor vote recommendations are considered solicitations under the securities laws and thus are prohibited by the anti-fraud provisions of Rule 14a-9 from containing any materially false or misleading statement.
2. Increased Disclosure Regarding Conflicts of Interest. The proposed rules would revise Rule 14a-2(b), which provides exemptions for proxy advisors from the information and filing requirements of the proxy rules. In order to continue to rely on these exemptions, proxy advisory firms would be subject to three conditions. The first is that they would have to disclose material conflicts of interest in their proxy voting advice, along with the policies and procedures that they have in place to identify and address these conflicts.
3. Issuers and Non-Exempt Solicitors to Have Opportunities for Pre-Publication Review. The second condition is that proxy advisors must provide an opportunity for issuers and investors engaged in non-exempt solicitations (such as those conducting a proxy fight) to identify factual errors or methodological weaknesses in proxy advisor reports before they are published. The window for review would be brief and available only if the issuer files its proxy more than 25 calendar days prior to the shareholder meeting date. Issuers and non-exempt solicitors would also have the opportunity to review the proxy advisor's final report no later than two business days prior to its publication to clients.
4. Issuers and Non-Exempt Solicitors to Have an Opportunity to Embed a Response in Proxy Advisor Reports. The third condition for a proxy advisor to rely on its exemption is that the final proxy advisor report as sent to clients would be required, if requested by the issuer or non-exempt solicitors, to include a hyperlink that allows clients to access the written views of the requesting party as to the proxy voting report as published.

Unless the deadline is extended, the proposed rules will be subject to public input during the standard 60-day comment period. Any new requirements will be subject to a one-year transition period following publication of a final rule. We continue to believe that the SEC proposed rules, together with the SEC guidance regarding proxy advisory firms issued this past August, will help to diminish the out-size influence the proxy advisory firms wield today in proxy contests, transactions subject to shareholder votes and annual meetings.

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