July 29, 2020

# SEC Adopts Amendments to Regulate Proxy Voting Advice

On July 22, 2020, the SEC adopted final amendments to its rules governing proxy solicitations and the filing exemptions for proxy voting advice (the "Amendments"). With Democratic Commissioner Lee dissenting, Chairman Clayton and the two Republican Commissioners closed the initial chapter in a more than decade-long attempt to rein in the influence of "proxy voting advice businesses" ("Proxy Advisers"). The Amendments condition the exemptions for reports issued by Proxy Advisers from the filing and information requirements of the federal proxy rules on compliance with disclosure and procedural requirements. In addition, the Amendments codify in the definition of "solicitation" in Rule 14a-1(l) the SEC's longstanding view that Proxy Advisers' reports are "solicitations" subject to the anti-fraud provision of the federal proxy rules. This Alert summarizes key aspects of the Amendments.

The SEC also supplemented its prior guidance regarding the proxy voting responsibilities of investment advisers in light of the Amendments. The supplemental guidance is discussed in greater detail in a separate Ropes & Gray Alert (available here).

## Observations

For companies, the biggest change is that **all** companies will now receive a copy of the Proxy Adviser's report – probably for free to comply with the safe harbor that the Amendments provide. The required conflicts of interest disclosure is unlikely to generate any information that at least the two larger Proxy Advisers are not already providing to their clients. The significant impact is more likely to come from the related guidance issued to investment advisers that use Proxy Advisers for proxy recommendations and vote execution. The guidance represents a stern warning that vote execution immediately upon issuance of a Proxy Adviser's report (so-called "robo-voting") – without considering the company's response – could be a breach of the investment adviser's duty to its clients. Whether this guidance affects a change in voting behavior or simply delays the time at which the votes are delivered will be the real test of the success of the SEC's efforts.

## Amendments to Rule 14a-2(b)

The Amendments revise Rules 14a-2(b)(1) and 14a-2(b)(3), which exempt advice issued by Proxy Advisers from the information and filing requirements of the proxy rules, to condition these exemptions on:

- Enhanced disclosure of material conflicts of interest by a Proxy Adviser in its proxy voting advice or in an electronic medium used to deliver the proxy voting advice;
- The Proxy Adviser's adoption and public disclosure of written policies and procedures reasonably designed to ensure that the Proxy Adviser:
    - Makes its proxy voting advice available to subject companies at or prior to the time it is initially issued to its clients; and
    - Provides its clients with a mechanism by which they can be timely notified of any written statements by a company regarding the proxy voting advice before the shareholder meeting.

***Enhanced Conflicts Disclosure.*** Under the Amendments, the enhanced conflicts of interest disclosures must include "prominent disclosure" of "any information regarding an interest, transaction, or relationship of the [Proxy Adviser] (or its affiliates) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction, or relationship" and "any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship."

Boilerplate language that these conflicts "may" exist will be insufficient for purposes of satisfying this condition to the exemptions. In a change from the proposal, the Amendments give a Proxy Adviser the option to include the required disclosure ***either*** in its proxy voting advice ***or*** in an electronic medium used to deliver the proxy voting advice instead of requiring such disclosure in both places, providing Proxy Advisers with significant flexibility over the manner in which conflicts of interest information is disclosed.

***Notice of Proxy Voting Advice and Response.*** The SEC's original proposal included review and feedback provisions between the company and the Proxy Adviser that would have taken place before the report was issued. While these provisions enjoyed much support in the corporate community, a substantial number of commenters were opposed. The principles-based requirements set forth above represent a significant departure from the original proposal. The Amendments neither require that Proxy Advisers provide companies (or other soliciting persons) with the opportunity to review proxy voting advice in advance of its dissemination to the Proxy Advisers' clients, nor do they require that proxy voting advice be made available to companies after being initially provided to clients, if it is later revised or updated in light of subsequent events. The Amendments do not require a Proxy Adviser to include, at the request of a company, a hyperlink in the voting advice to the company's statement about the voting advice. Although the SEC encourages cooperation and an open dialogue between Proxy Advisers and public companies, the Amendments do not require a Proxy Adviser to negotiate or otherwise engage in a dialogue with a company or revise its voting advice in response to any company feedback.

Proxy Advisers do not need to comply with these new requirements to the extent that their proxy voting advice is based on a custom voting policy that is proprietary to a Proxy Adviser's client or any portion of the proxy voting advice provided with respect to certain mergers and acquisitions transactions or proxy contests.

The Amendments provide two non-exclusive safe harbors to give Proxy Advisers assurance that their written policies and procedures satisfy the requirements of Rule 14a-2(b). One of these safe harbors specifies that a Proxy Adviser's policies and procedures may condition receipt of a subject company's report on the company having (1) filed its definitive proxy statement at least 40 calendar days before its shareholder meeting and (2) expressly acknowledged that it will only use the proxy voting advice for internal purposes and in connection with the solicitation and will not publish or otherwise share the proxy voting advice except with its employees and advisers.

## Amendments to Rule 14a-1(l): Codification of the SEC's Interpretation of "Solicitation"

The Amendments codify the SEC's interpretation that proxy voting advice constitutes a solicitation subject to the federal proxy rules. They amend Rule 14a-1(l) to make clear that the term "solicitation" includes 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 who markets its expertise as a provider of such advice, separately from other forms of investment advice, and sells such advice for a fee. In addition, the Amendments codify the SEC's view that any proxy voting advice furnished by a person who furnishes such advice only in response to an unprompted request will not be deemed a solicitation.

## Amendments to Rule 14a-9

Proxy voting advice exempt from filing under Rule 14a-2(b) exemptions is not exempt from Rule 14a-9, which prohibits materially false or misleading misstatements or omissions in proxy solicitations. The Amendments add the following to the four examples of potentially misleading statements in the note to Rule 14a-9: "Failure to disclose material information regarding proxy voting advice . . . such as the [Proxy Adviser's] methodology, sources of information, or conflicts of interest." In another change from the proposal, the SEC did not adopt the proposed clause "or use of standards that materially differ from relevant standards or requirements that the Commission sets or approves" due to concerns about the lack of clarity regarding the scope of the proposed clause, which could increase legal uncertainty and litigation risks to both Proxy Advisers and companies.

## Effectiveness; Compliance Period

The Amendments will become effective 60 days after they are published in the *Federal Register*, but Proxy Advisers will not be required to comply with the amendments to Rule 14a-2(b)(9) until December 1, 2021. However, the lengthy transition period only applies with respect to the amendments to Rule 14a-2(b)(9) and does not extend to the amendments to Rule 14a-1(l) and Rule 14a-9.

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If you have any questions about this Alert, please contact your usual legal advisor at Ropes & Gray.