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Insights

SEC AMENDS PROXY RULES TO ADDRESS PROXY VOTING ADVISORS AND ISSUES GUIDANCE FOR INVESTMENT ADVISERS ON USE OF AUTOMATED VOTING PLATFORMS

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On July 22, 2020, the SEC took action to address two aspects of the proxy voting process: (1) amending the proxy solicitation rules with respect to "proxy voting advice businesses" (PVABs or proxy advisory firms), such as ISS and Glass Lewis, and (2) the widespread use of automated proxy voting tools by PVABs to allow their investment advisor and institutional investor clients to cast votes.

ISS filed a lawsuit against the SEC challenging its guidance issued last August that proxy advisor vote recommendations constitute "solicitations". The parties agreed to stay the lawsuit until the SEC adopted final rules. As a result, it is uncertain how ISS plans to proceed in light of the amended rules.

AMENDMENT TO PROXY SOLICITATION RULES

The SEC amendments to the proxy solicitation rules that effected three principal changes.

Proxy voting advice as solicitation

First, the amended rules codify the SEC's previous interpretation (discussed in our October 2019 newsletter) that proxy voting advice produced by PVABs generally constitutes a "solicitation" for purposes of Rule 14a-1(l) of the Securities Exchange Act of 1934. A new subparagraph addresses when a person who furnishes proxy voting advice will be deemed to be engaged in a solicitation subject to the proxy rules. The definition covers persons who make voting recommendations to shareholders who market their expertise separately from other forms of investment advice, and sell such advice for a fee. It excludes advice furnished only in response to an unprompted request.

Requirements for exemption

Second, in order for PVABs to qualify for exemptions from the information and filing requirements of the proxy rules, the amended rules require the following:

- ***Disclosure of material conflicts and related policies and procedures***
  PVABs must provide disclosure of material conflicts of interest to their clients with sufficient detail to understand the nature and scope of the interest, transaction or relationship, as well as any policies and procedures used to identify, and steps taken to address, any such material conflicts. This is intended to make it easier for clients, including their investment advisers, to assess the objectivity and reliability of the voting advice of PVABs.
  - Examples of potential conflicts cited by the SEC include making recommendations on annual meeting proposals or providing governance ratings while also (i) advising on corporate governance or compensation policies for registrants, or helping increase governance scores; (ii) having a material interest in a proposal through an affiliate or through one or more client relationships; or (iii) advising on how to structure or present the registrant's proposal or business terms.
  - The required disclosure may be included either in the proxy voting advice or in an electronic medium used to deliver the advice, such as a client voting platform.
- ***Concurrent access by registrants to recommendations of proxy advisory firms***
  PVABs must establish policies and procedures reasonably designed to allow registrants that are the subject of the PVABs' voting advice to be able to access that advice prior to or at the same time as the advice is disseminated to clients ("registrant notice" requirement).
  - Due to timing constraints, the amended rules provide that the requirement does not apply to later revisions or updates to advice, such as those reflecting subsequent events.
  - A safe harbor is available if such policies and procedures are reasonably designed to provide registrants with a copy of such proxy voting advice, at no charge, no later than the time it is disseminated to the business's clients. The safe harbor also specifies that such policies and procedures may include conditions requiring registrants to (i) file their definitive proxy statement at least 40 calendar days before the shareholder meeting and (ii) expressly acknowledge that they will only use the proxy voting advice for their internal purposes and/or in connection with the solicitation and will not publish or otherwise share the proxy voting advice except with the registrant's employees or advisers.
- ***Availability of responses by registrants to voting recommendations issued by proxy advisory firms***
  A PVAB must adopt and publicly disclose policies and procedures reasonably designed to ensure it provides clients with a mechanism by which they can reasonably be expected to become aware of any written responses by registrants to such voting advice, in a timely manner before the shareholder meeting or other action ("registrant response access"

requirement).

- A safe harbor is available if such policies and procedures are reasonably designed to provide notice on the electronic client platform of the PVAB or through email or other electronic means that the registrant has filed, or has informed the PVAB that it intends to file, additional soliciting materials setting forth the registrant's statement regarding the advice (and include an active hyperlink to those materials on EDGAR when available).
- The SEC reaffirmed its position that including the hyperlink would not, by itself, make a PVAB liable for the content, as that depends on involving itself in the preparation of the information or explicitly or implicitly endorsing or approving the information.

Requirements as principles-based. The above requirements are principles-based, intended to provide flexibility as to the level of detail included in the disclosure, as well as the specific elements of the required policies and procedures. However, the adopting release lists various factors that would be relevant in the analysis as to whether the policies and procedures are "reasonably designed" to accomplish the objectives of the registrant notice requirement and the registrant response access requirement.

Exemptions from requirements of registrant notice and registrant response access. The amendments provide that the registrant notice and registrant response access requirements do not apply where the proxy voting advice is based on a "custom policy" that is proprietary to a particular PVAB's client. Similarly, due to time constraints, those requirements do not apply to non-exempt solicitations relating to M&A (i.e., matters described in Rule 145(a) of the Securities Act of 1933) or contested matters such as proxy fights, although they would apply to any other proposals being presented at the relevant meeting. In both cases, however, such advice will still constitute "solicitation" subject to Rule 14a-9.

Application of antifraud rule to proxy advice

Third, the amended rules add new examples to Rule 14a-9 – the antifraud provision of the proxy rules -- to make clear that the failure to disclose material information regarding proxy voting advice, "such as the proxy voting advice business's methodology, sources of information, or conflicts of interest" could, depending on the particular facts and circumstances, be misleading within the meaning of the rule.

Although acknowledging that the amendments may increase the cost of compliance of PVABs, the SEC does not believe the amendments will have a material impact, and that the market generally, including PVABs themselves, have previously recognized that such services constitute "solicitation," and reflect the same in their pricing and the delivery of their services. Further, the SEC believes the rules reflect appropriate revisions from the earlier proposals to address constitutional issues under the First and Fifth Amendments.

The amended rules will become effective 60 days after publication in the Federal Register. However, PVABs will not be required to comply with the new requirements described above until December 1, 2021.

SUPPLEMENTAL GUIDANCE REGARDING AUTOMATED VOTING

Last August, the SEC issued supplemental guidance to investment advisers reaffirming that they must fulfill their fiduciary duty when voting proxies for clients, including when they retain professional voting advice businesses for help, and offered several considerations for this purpose.

The SEC issued new supplemental guidance relating to the proxy voting responsibilities of investment advisers when using automated voting (also called robo-voting) features offered on the electronic platforms of PVABs. These platforms typically contain features that (1) pre-populate clients' electronic ballots with the PVABs' voting recommendations, and (2) automatically submit those ballots for counting. With the help of such features, a client could effectively "set-it-and-forget-it," allowing the proxy voting advice business to produce recommendations that determine the client's vote, without further action by the client.

The SEC has previously said that if investment advisers have assumed the authority to vote on behalf of their clients, they have the obligation to exercise that authority in the best interests of their clients, which includes making voting decisions on an informed basis. The new guidance reminds advisers that this obligation applies, regardless of whether an adviser utilizes automated voting features. The policies and procedures that investment advisers are already required to have with respect to voting securities of their clients should be reasonably designed to allow for consideration of new material information about a matter (if received with enough time to review prior to casting a vote), whether the advisers utilize automated voting features or not. Such new information could include a registrant's response to proxy voting advice of a PVAB.

The guidance also notes that, in light of the timing of automated voting, PVABs may gain possession of non-public information about how investment advisers will vote. As a result, the guidance states that investment advisers should consider reviewing their agreements with PVABs to determine whether they permit such business to utilize such information in a manner contrary to their clients' best interest.

An investment adviser also has an obligation, as a result of its duty of loyalty to clients, to make full and fair disclosure to its clients of all material facts relating to the advisory relationship. The guidance suggests that advisers should consider whether their use of automated voting features is such a material fact and, if it is, whether they are providing sufficiently specific information so that a client is able to understand the role of automated voting in the investment adviser's exercise of voting authority.

The supplemental guidance will become effective upon publication in the Federal Register.

For further information on this topic, please contact Randy Wang or any other BCLP Securities and Corporate Governance lawyer. Additional resources are available on our Website for the BCLP Securities and Corporate Governance Practice. Bryan Cave Leighton Paisner LLP makes available the information and materials in its Website for informational purposes only. The information is general in nature and does not constitute legal advice. Further, the use of this site, and the sending or receipt of any information, does not create any attorney-client relationship between us. Therefore, your communication with us through this Website will not be considered as privileged or confidential.

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