

THAT WAS QUICK! SEC REVERSES KEY ELEMENTS OF 2020 AMENDMENTS TO RULES FOR ISS, GLASS LEWIS AND OTHER PROXY ADVISORS

Jul 14, 2022

As discussed in our [July 24, 2020 client alert](#), the SEC amended the proxy rules to establish a framework for proxy advisors such as ISS and Glass Lewis to remain exempt from proxy rule information and filing requirements. Only ten months later, it [directed the SEC Staff to re-examine those rules](#). And less than two years after their adoption, on July 13, 2022, the SEC [voted to rescind](#) key elements of the new conditions for proxy advisors to qualify for the exemption:

- That advisors make their advice available to companies at or before they make advice available to clients
- That advisors provide clients with a mechanism by which they could reasonably be expected to become aware of any written statements or responses of companies to advice published by advisors

Additionally, the SEC rescinded:

- Note (e) to Rule 14a-9 providing examples of material misstatements or omissions relating to proxy voting advice
- Supplemental guidance for investment advisors about their proxy voting obligations and use of automated proxy voting tools

The remaining elements of the 2020 rules described in our [July 24, 2020 client alert](#) will remain in effect:

- That proxy voting advice generally constitutes a “solicitation” subject to proxy rules
- Proxy advisors must provide disclosure of material conflicts of interest
- That proxy voting advice is subject to liability under the Rule 14a-9 antifraud provision

The 2020 amendments were adopted on a party line vote by a Republican-majority SEC. A majority of the SEC Commissioners are now Democrats, each of whom voted to approve the reversal of the 2020 amendments.

The amendments and rescission of guidance will be effective 60 days after publication in the Federal Register.

Concerns voiced by dissenting Commissioners

Commissioners Peirce and Uyeda issued strong dissents to the reversal of the 2020 amendments. Peirce focused on:

- “The dearth of new evidence to support the Redo Proposal,” citing a commenter who noted that:

“It is not possible to conduct an economic or cost benefit analysis for a rule that has not gone into effect, and the decision to amend a finalized rule without such data may have the unintended consequence of establishing an undesirable precedent impacting regulatory stability going forward.”
- “Limited incentives [for proxy advisors] to engage with public companies, particularly smaller ones, to correct errors”
- Uncertainty as to whether “proxy advisors’ current voluntary engagement practices, even if they are good, will continue”
- The impact on the creditability of the SEC from “[c]hanging course so dramatically with so little justification” such that “people might start to wonder whether the GPS we are using is calibrated to respond to political rather than market signals”

At his first official meeting as a Commissioner, Uyeda expressed agreement with Peirce, citing:

- “[C]oncerns that this regulatory seesaw does not reflect administrative ‘best practices’ that promote long term reliance and confidence by market participants in the stability of important areas of securities regulation”
- The failure of the deletion of Note (e) to “provide regulatory clarity”, particularly as the language of the former Note is included in the adopting release
- The “needlessly compressed” comment period
- The belief that, because the SEC’s expressed confidence in “voluntary measures and market-based incentives [as being] effective and sufficient” for proxy advisors, it should “apply this reasoning and consider similar alternatives in lieu of prescriptive disclosure requirements”

The SEC's reasons for its quick reversal of rules

Based on comments from institutional investors and others, the SEC determined that the risks posed by the 2020 amendments on the cost, timeliness and independence of proxy voting advice were not justified by the benefits. The SEC cited:

- Studies and surveys cited by opposing commenters as insufficient to demonstrate the prevalence of errors by or disagreements with proxy advisors
- Voluntary practices adopted by some proxy advisors, which the SEC believes are incentivized to engage with companies
- Legal uncertainties created by the Note (e), which provided examples of material misstatements or omissions by a proxy advisor, including with respect to its methodology, sources of information or conflicts of interest

In response to criticism for proposing to rescind the conditions contained in the 2020 amendments before their effective date, the SEC cited:

- The important role of proxy advisors in the voting process and scope of potential consequences of disruption
- The majority of clients that commented on the 2020 conditions as having opposed them
- Reliance interests implicated by rescission as being limited

Additionally, [Commissioner Lee](#) cited three instances which she asserted were examples where the SEC “changed course with respect to rules that had been on the books a very short time.”

In the case of Note (e), the SEC believes it creates uncertainty as to the application of the Rule 14a-9 antifraud provision to voting advice, unnecessarily increasing litigation risk to advisors and impairing the independence of that advice. Further, the SEC stated that the Note did not change the Rule’s application or scope and that a proxy advisor would have liability for material misstatements or omissions in its proxy voting advice, including – depending on the facts and circumstances – with respect to the elements covered by the Note: its methodology, sources of information or conflicts of interest. The [Adopting Release at pages 55-58](#) contains a detailed summary of the “limited circumstances” in which a proxy advisor’s statement of opinion may create liability under Rule 14a-9.

Recommendations

In light of the SEC rescission of the 2020 amendments, companies should continue to monitor proxy voting reports of advisors and evaluate whether to take steps to respond to errors. According to the SEC:

- Glass Lewis and Egan-Jones offer companies some form of pre-release review of at least some of their proxy voting advice reports, or the data used in their reports
- ISS does not provide draft proxy voting advice to U.S. companies, but engages with them during the process of formulating its proxy voting advice
- All three firms offer companies access to proxy voting advice after it is distributed to clients, in some cases for a fee, and provide some means for companies to provide feedback on such advice
- ISS provides their clients with notifications of and links to filings by companies that are the subject of proxy voting advice in its online platform

Of course, the SEC reversal means that companies will be forced to play catch-up to respond to any errors during an even shorter window before shareholder meetings.

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