

# SEC proposes amendments to proxy rules applying to proxy advisory firms

DECEMBER 5, 2019 11 MIN READ

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In November 2019, the U.S. Securities and Exchange Commission (SEC) issued proposed amendments to its proxy rules to regulate certain of the activities of proxy advisory firms. The proposed amendments follow guidance issued by the SEC in August 2019 addressing the application of the SEC's antifraud rules to communications from proxy advisory firms and the responsibilities of investment advisers that use services of proxy advisory firms, which were described in our Osler Update, "[SEC issues guidance regarding activities of proxy advisory firms](#)." The proposed amendments amend the definition of "solicitation" to expressly include the activities of proxy advisory firms and require such firms

- to disclose conflicts of interest in each of their reports
- to provide issuers and certain proxy soliciting persons with an advance draft of their proposed advice for review and comment
- if requested by the issuer or proxy soliciting person, to include in the proxy advisor's report a hyperlink or equivalent to a written statement by the issuer or proxy soliciting person setting out its views on the advice by the proxy advisory firm

The proposed amendments are intended to help ensure investors who use proxy voting advice to inform their voting decisions receive more accurate, transparent and complete information from proxy advisory firms.

## Application of SEC solicitation rules to proxy advisory firms

Under the SEC's proxy rules, any person engaging in a proxy solicitation for any security that is registered under the Securities Exchange Act of 1934 (such as shares listed on U.S. stock exchanges) is, absent an exemption, subject to filing and information requirements designed to ensure that complete and accurate information is provided to shareholders solicited by that person. Among other things, the person making the solicitation is required to prepare a proxy statement with the extensive information prescribed by Schedule 14A under the SEC's proxy rules, together with a proxy card in a specified format, file the materials with the SEC, and furnish the materials to every shareholder who is solicited.

In August, the SEC issued guidance stating that in its interpretation, the voting advice communications from proxy advisory firms are generally solicitations and subject to SEC antifraud rules prohibiting proxy solicitations from containing materially false or misleading statements. Recognizing that compliance with its proxy rules is burdensome, certain types of solicitations are exempt from the information and filing requirements of its proxy rules, and the SEC guidance noted that proxy advisory firms have historically been able to avail themselves of exemptions for solicitations by persons who do not seek the power to act as a proxy for a shareholder and do not have a substantial interest in the relevant subject matter, as well as voting advice provided by an advisor to any other person with whom the advisor has a business relationship.

In October, Institutional Shareholder Services (ISS) commenced an action in the District Court for the District of Columbia challenging the SEC's authority, arguing that its activities are not solicitations and the SEC guidance was a substantive change that should have been subject to notice-and-comment review.

The SEC is now proposing to amend the definitions of "solicit" and "solicitation" in its proxy rules to expressly include any 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 that advice for a fee. The SEC proposes to retain existing exemptions from information and filing requirements available to proxy advisory firms, but condition their availability upon the inclusion of additional disclosures by proxy advisory firms about their actual or potential conflicts of interest and compliance with new procedures to provide issuers an opportunity to review and provide feedback on proxy advice before it is disseminated to investors.

In addition, the SEC is also proposing to amend the definitions of "solicit" and "solicitation" to expressly exclude any proxy voting advice provided by a person who provides advice only in response to an unprompted request.

In explaining the rationale for its proposed amendments, the SEC noted that given that proxy advisory firms provide voting advice to thousands of clients that exercise voting authority over a significant number of shares voted annually, it is vital that proxy voting advice be based on the most accurate information possible and that proxy advisory firms be transparent with their clients about the processes and methods used to formulate their advice.

## Conflicts of interest

To help achieve these goals, the SEC proposes to introduce changes to the existing exemptions relied upon by proxy advisory firms to require more disclosure about actual or

potential conflicts of interest a proxy advisory firm may have with respect to a voting recommendation that could influence the proxy advisory firm's advice. Examples cited by the SEC of potential conflicts include a proxy advisory firm providing

- voting advice to its clients on proposals while the proxy advisory firm also earns fees from providing corporate governance advice and compensation policies
- voting advice on a matter in which its affiliates or one of its clients has a material interest, such as a business transaction or a shareholder proposal put forward by that client
- ratings to institutional investors of issuers' corporate governance practices while at the same time consulting for issuers that are the subject of those ratings to help increase their corporate governance scores
- voting advice with respect to an issuer's shareholder meeting while affiliates of the proxy advisory firm hold a significant ownership interest in the issuer, sit on the issuer's board of directors, or have relationships with a shareholder presenting a proposal that is covered in the proxy advisory firm's advice

The SEC noted that while the exemption relied upon by proxy advisory firms, in its current form, does require advisors to disclose the existence of significant relationships and interests, those requirements do not focus specifically on conflicts of interest and often elicit boilerplate disclosures. As a result, as a condition to being exempt from the information and filing requirements of the SEC's proxy rules, proxy advisory firms would be required to prominently disclose in their reports

- any material interests, direct or indirect, of the proxy advisory firm (or its affiliates) in the matter or parties concerning which it is providing the advice
- any material transaction or relationship between the proxy advisory firm (or its affiliates) and (i) the issuer (or any of its affiliates), (ii) another soliciting person (or its affiliates), or (iii) a shareholder proponent (or its affiliates), in connection with the matter covered by the proxy advice
- any other information regarding the interest, transaction, or relationship of the proxy advisory firm (or its affiliate) that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular relationship
- any policies and procedures used to identify, as well as the steps taken to address, any material conflicts of interest arising from such interest, transaction or relationship

The SEC emphasized that the conflict of interest disclosures should be sufficiently detailed so that clients can understand the nature and scope of the interest, transaction or relationship to assess the objectivity and reliability of the voting advice they receive. These details may include the identities of the parties or affiliates involved in the interest, transaction, or relationship triggering the proposed disclosure requirement and, when necessary for the client to assess the potential effects of the conflict of interest, the approximate dollar amount involved in the interest, transaction or relationship. The discussion of the policies and procedures, if any, used to identify and steps taken to address conflicts of interest would include a brief description of their material features, such as the types of transactions they cover and the persons responsible for administering them.

## Issuers' review of proxy voting advice and response

The SEC noted that many issuers have also expressed concern that they lack an opportunity

to review proxy voting advice before it is disseminated; meaningful opportunities to engage with proxy advisory firms and to correct factual errors or methodological weaknesses in their analyses are lacking; and once voting advice is delivered to clients, which often occurs very shortly before a significant percentage of votes are cast, it is not possible for issuers to inform investors on a timely basis of their contrary views or to point out errors they have identified in the analyses.

In response to such concerns, the SEC is proposing to require proxy advisory firms to provide issuers and other proxy soliciting persons<sup>[1]</sup> with an advance draft of their proposed advice for review and comment. The review and comment period would vary based on the number of days before the meeting date the definitive proxy materials are filed with the SEC.

<b>Materials are filed:</b>	<b>No. of days of review:</b>
45 or more days before the meeting date	five business days
less than 45 days and at least 25 days before the meeting date	three business days
less than 25 days before the meeting date	no advance review required

Proxy advisory firms would not be required to revise their report in response to comments from issuers and other proxy soliciting persons, but will need to consider whether to do so in light of the requirement that there be no material misstatements or omissions in their solicitations.

Proxy advisory firms would also be required to provide issuers and other proxy soliciting persons with a final notice of their voting advice no later than two business days prior to the dissemination of advice to clients, regardless of whether the issuer or other proxy soliciting person provided feedback during the review and feedback period.

If requested by the issuer or other proxy soliciting persons, the proxy advisory firm would also be required to include in its final advice a hyperlink<sup>[2]</sup> directing the recipient of the advice to a written statement that sets forth the issuer's or other proxy soliciting person's views on the advice.<sup>[3]</sup> Including the hyperlink would require some co-ordination so that the proxy advisor's report and the issuer's or other proxy soliciting person's views on it are released at the same time, but the SEC is not proposing any prescribed method by which proxy advisory firms and issuers and other proxy soliciting persons would be required to co-ordinate with each other.

Proxy advisory firms may offer the clients more than one benchmark voting policy or guidelines in formulating their voting recommendations for a particular matter. The SEC has expressed the view that the voting recommendation formulated under each such benchmark voting policy or guidelines is a separate communication for purposes of the rule amendments.

An immaterial or unintentional failure to comply with the requirements of the SEC's proposed amendments would not result in a loss of the exemption from the information and filing requirements of the SEC's proxy rules for a proxy voting firm so long as it made a good faith effort to comply and to the extent it is feasible to do so, the proxy advisory firm uses reasonable efforts to substantially comply as soon as practicable upon becoming aware of noncompliance.

## Amendments to antifraud provisions of proxy rules

The SEC's proxy rules prohibit any proxy solicitation (even those that are exempt from the information and filing requirements of the proxy rules) from containing false or misleading statements with respect to any material fact. In its August 2019 guidance, the SEC stated that this antifraud provision in Rule 14a-9 under the 1934 Act applies to proxy voting advice.

Consistent with its guidance, the SEC is also proposing to amend Rule 14a-9 to list additional examples of the types of information that could be covered by Rule 14a-9, including (i) a failure to disclose a proxy voting firm's business methodology, sources of information and conflicts of interest and (ii) a failure to disclose the proxy advisory firm's use of standards (such as director independence requirements) that materially differ from relevant requirements or standards that the SEC sets or approves.

## Canadian implications

The SEC's proxy rules do not apply to securities of most Canadian companies that are registered under Section 12 of the 1934 Act, such as companies with cross-listings on the New York Stock Exchange or Nasdaq Stock Market, because of an exemption available for foreign private issuers. However, the SEC's proposed amendments would apply to proxy voting advice covering securities of Canadian companies that are registered under Section 12 and that must comply with the SEC's proxy rules and may influence practices by proxy advisory firms generally in Canada.

In April 2015, Canadian Securities Administrators (CSA) issued National Policy 25-201 – *Guidance for Proxy Advisory Firms*, providing guidance for proxy advisory firms operating in Canada with respect to the identification, management, mitigation and disclosure to their clients of potential conflicts of interest, the devotion of resources to prepare rigorous and credible vote recommendations and transparency regarding the development of proxy voting guidelines. If the SEC's proposed amendments are adopted, the CSA may choose to revisit its guidance and may also adopt similar measures to regulate the activities of such firms.

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[1] Proxy voting firms would not be required to provide advance review and feedback to persons conducting solicitations that are exempt from the information and filing requirements of the SEC's proxy rules.

[2] The SEC states that in its view, the proxy advisory firm would not be liable for the content of the statement of the issuer or other proxy soliciting person solely due to inclusion of a hyperlink.

[3] Any such statements would also have to be filed with the SEC as additional soliciting material under Rule 14a-12 of the 1934 Act no later than the date of the release of the proxy voting advice containing the hyperlink.