

SEC Makes it Official — Proxy Advisory Firms Are Subject to Proxy Solicitation Rules

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Securities and Capital Markets

On July 22, 2020, the Securities and Exchange Commission (SEC) adopted several [proxy rule amendments](#) dealing with proxy advisory firms as part of its ongoing effort to modernize the proxy voting system. The proxy rule amendments, which were [proposed](#) in November 2019, codify the SEC's view that proxy voting advice generally constitutes a solicitation under the proxy rules. At the same time, proxy advisory firms may still rely, subject to new conditions, on certain exemptions from the most burdensome provisions of the SEC's proxy rules. In addition, the proxy rule amendments make clear that failure to disclose material information about proxy voting advice may be considered misleading under the anti-fraud provision of the proxy rules.

Certain proposed amendments were not included in the final rules. Notably absent is the requirement for proxy advisory firms to provide a company with its proxy voting advice for the company's review and comment prior to the distribution of the proxy voting advice to the proxy advisory firm's clients.

In conjunction with the proxy rule amendments, the SEC also voted to publish supplemental [guidance](#) to investment advisers related to how proxy voting advice should be used when making their voting decisions.¹

The proxy rule amendments are part of the SEC's ongoing focus on modernizing the proxy process. This focus dates back to a 2010 [proxy plumbing Concept Release](#) and, more recently, a staff [proxy process roundtable](#) in 2018. Additionally, the supplemental guidance follows the SEC's recent interpretive guidance clarifying the applicability of the proxy rules to [proxy voting advice](#) and the [proxy voting responsibilities](#) of investment advisers.

¹ The SEC voted 3–1 to adopt the proxy rule amendments and the supplemental guidance to investment advisers.

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Amendments to Definition of “Solicit” and “Solicitation”

Rule 14a-1(l)(iii) of the SEC’s proxy rules under the Securities Exchange Act of 1934 defines a “solicitation” as including any “communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.” The SEC has interpreted the term broadly and, in guidance published in August 2019, stated its view that “solicitation” encompasses the furnishing of proxy voting advice by proxy advisory firms. However, some have questioned this view. By adopting the proxy rule amendments, the SEC has codified this position and delineated what proxy voting advice constitutes a “solicitation.”

- **Engaged in a Solicitation.** The proxy rule amendments clarify that the terms “solicit” and “solicitation” include any proxy voting advice which (a) makes a recommendation to a shareholder as to a vote, consent, or authorization on a matter for which shareholder approval is solicited, and (b) is furnished by a person who markets its expertise as a provider of such advice and sells such advice for a fee.²
- **Not Engaged in a Solicitation.** The proxy rule amendments also provide, however, that proxy voting advice given by a person who furnishes such advice only in response to an unprompted request shall *not* be deemed to be a solicitation.³ This codifies the SEC’s historical view that such a communication should not be regarded as a solicitation subject to the proxy rules.⁴

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Exempt Solicitations

Irrespective of whether voting recommendations of proxy advisory firms may be considered solicitations, they have generally been considered exempt from the filing and disclosure requirements of the proxy rules by virtue of two existing exemptions. One such exemption is available for solicitations by persons who do not seek the power to act as a proxy for a shareholder and do not have substantial interest in the subject matter of the communication beyond their interest as a shareholder.⁵ The other exemption is available for proxy voting advice furnished by an advisor to any other person with whom the advisor has a business relationship.⁶ The proxy rule amendments provide that proxy advisory firms may not rely on these exemptions unless they comply with new Rule 14a-2(b)(9), which requires disclosure of conflicts of interests and appropriate policies and procedures, as follows.

² Rule 14a-1(l)(1)(iii)(A).

³ Rule 14a-1(l)(2)(v).

⁴ See [Exemptions from the Proxy Rules for Proxy Voting Advice](#), Release No. 34-89372, Fn. 84.

⁵ Rule 14a-2(b)(1).

⁶ Rule 14a-2(b)(3).

- **Disclosure of Material Conflicts of Interest.** Proxy advisory firms must provide specified conflict of interest disclosure in their proxy voting advice or in an electronic medium used to deliver the proxy voting advice to their clients.⁷
- **Policies and Procedures.** Proxy advisory firms must adopt and publicly disclose written policies and procedures reasonably designed to ensure that:
 - the proxy advisory firm makes its proxy voting advice regarding a particular issuer available to such issuer at or prior to the time such advice is disseminated to the proxy advisory firms' clients;⁸ and
 - the proxy advisory firm provides its clients with a mechanism by which those clients can reasonably be expected to become aware of any written statements by issuers regarding the firm's proxy voting advice about those issuers, in a timely manner before the applicable shareholder meeting.⁹
- **Safe Harbors:** To provide assurance to a proxy advisory firm that its written policies and procedures satisfy the above requirements, the proxy rule amendments include two non-exclusive safe harbors.
 - A proxy advisory firm will be deemed to satisfy the written policies and procedures requirement if those policies and procedures are reasonably designed to provide issuers with a copy of its proxy voting advice, at no charge, no later than when the advice is provided to the firm's clients. But, the safe harbor also specifies that such policies may include conditions requiring an issuer to (i) file its definitive proxy statement at least 40 calendar days before the shareholder meeting and (ii) expressly acknowledge that the issuer will only use the proxy voting advice for its own internal purposes and will not publish or share the proxy voting advice except with the issuer's own employees or advisers.
 - A proxy advisory firm will be deemed to satisfy the requirement to make clients aware of issuers' statements regarding proxy voting advice, if its policies and procedures are reasonably designed to provide notice on its electronic client platform or through email or other electronic means that the registrant has filed, or has informed the proxy advisory firm that it intends to file, additional soliciting materials setting forth the issuer's statement regarding the advice (and include an active hyperlink to those materials on EDGAR when available).

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Modifications to Rule 14a-9

- **Anti-Fraud Considerations:** The proxy rule amendments modify Rule 14a-9 by adding several new examples that illustrate when the failure to disclose certain material information along with proxy voting advice could, depending on the facts and circumstances, be considered misleading within the meaning of the rule. This includes

⁷ Rule 14a-2(b)(9)(i).

⁸ Rule 14a-2(b)(9)(ii)(A).

⁹ Rule 14a-2(b)(9)(ii)(B).

failing to disclose material information about the proxy advisory firm's methodology, sources of information, or conflicts of interest.

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Investment Adviser Supplemental Guidance

- **Supplement to Prior Guidance.** The SEC also supplemented [prior guidance](#) issued in 2019 to investment advisers regarding their proxy voting responsibilities. The prior guidance focused on how an investment adviser's fiduciary duty and Rule 206(4)-6 under the Investment Advisers Act of 1940 related to an investment adviser's exercise of voting authority on behalf of its clients.
- **Proxy Voting Responsibilities.** The [supplemental guidance](#) is intended to assist investment advisers in fulfilling their proxy voting responsibilities in light of the proxy rule amendments. This includes circumstances in which the investment adviser utilizes a proxy advisory firm's electronic vote management system that automatically populates the investment adviser's voting ballots with suggested voting recommendations or for voting execution services. The supplemental guidance suggests that an investment adviser should take additional steps, such as assessing the pre-populated votes, considering additional information that may become available before the relevant votes are cast, and reviewing its policies and procedures to ensure that the adviser exercises its voting authority in its client's best interest.

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What Happens Next?

- **Proxy Solicitation Rules Effective Date.** Proxy advisory firms will not be required to comply with Rule 14a-2(b)(9) until December 1, 2021. The transition period, however, does not extend to the amendments to Rule 14a-1(l) and Rule 14a-9, which will be effective 60 days after publication of the final rules in the Federal Register.

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