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# SEC ISSUES FINAL RULES REGARDING PROXY ADVISER RECOMMENDATIONS

On July 22, the SEC issued final rules regarding proxy advisers, such as Institutional Shareholder Services (ISS) and Glass Lewis, who provide proxy recommendations to persons making proxy voting decisions. The final rules follow intense, and divided, commentary on the proposed rules issued in November 2019. They are significantly less burdensome than the proposed rules.

The final rules include the following procedures that must be implemented by December 1, 2021:

- The registrant must receive a copy of the proxy adviser's advice no later than the time it goes to the proxy adviser's clients;
- The proxy adviser must have a mechanism in place to inform its clients if the registrant files a response; and
- The proxy adviser must have certain procedures in place to deal with conflicts of interest.

The final rules also provide that the proxy advice may be considered false or misleading if the proxy adviser fails to disclose its methodology, sources of information, or conflicts.

“Supplemental Guidance” issued the same day suggests an investment adviser may be derelict in its fiduciary duties if it bases its voting decisions solely on the proxy adviser's recommendations without considering any supplemental filing by the registrant.

## Background

For over a decade the SEC has been considering the role of proxy advisers, such as ISS and Glass Lewis, in the shareholder voting process. There has been both criticism and praise of the roles played by these entities. Fiduciaries, who can be responsible for voting decisions for thousands of companies, focus on the cost benefits of being able to purchase research to guide their decisions at a much cheaper price than doing all the work themselves. Registrants focus on what they consider mistakes in the proxy statement analysis, which can consist of disagreement with the methodology used by the advisers or, in some cases, factual errors.

The SEC issued complex proposed rules in November 2019 to regulate proxy advisers. On July 22, the SEC issued final rules, which are considerably less burdensome. Proxy advisers must comply with the new rules by December 1, 2021 (though the rule change described below regarding false and misleading information appears to be effective 60 days after publication of these rules).

## Rules Regarding Proxy Advice

Subject to certain exceptions described below, under the final rules, registrants must be provided the proxy adviser's advice no later than the time it is made available to clients. The proxy adviser can condition delivery on the registrant's proxy statement being filed at least 40 days before the meeting and the registrant's agreement that it will only use the proxy advice for internal purposes or in connection with the proxy solicitation.

Further, the proxy adviser must provide its clients "in a timely manner" with a mechanism by which they can be aware of any written statements by the registrant regarding the proxy advice. This requirement can be fulfilled either by providing notice on the proxy adviser's electronic platform or by sending an email to its clients regarding the registrant's filing.

There are several exceptions to the new procedures:

- They do not apply to additional versions of the adviser's proxy voting advice after the initial recommendation;
- They do not apply to advice based on custom voting policies proprietary to a client;
- They do not apply to advice concerning approval of a merger, asset sale, or similar transaction; and
- They do not apply to recommendations by any person for the purpose of opposing a solicitation by another person.

## Rules Regarding the Proxy Advice Process

The following new procedures are designed to protect the integrity of the proxy advice process.

The proxy voting advice must prominently disclose any information regarding an interest, transaction, or relationship of the proxy advice business (or its affiliates) that is material to assessing the objectivity of the proxy voting advice. The proxy adviser must also disclose any policies or procedures it maintains to identify and deal with any material conflicts. In both cases, the disclosure can be made on the actual proxy voting advice report or via the electronic medium used to deliver the proxy voting advice.

Depending on the proxy adviser, this rule may not represent much of a change. For example, the ISS ProxyExchange platform already discloses details of potential conflicts of interest and Glass Lewis indicates that its disclosures appear on the front cover of its reports. Both firms have publicly available conflict of interest policies.

In addition to the new procedures described above, the list of examples of potentially "false and misleading statements" under the proxy rules has been expanded to include "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." This expansion may turn out to have a significant impact on some aspects of the proxy advice process.

For example, ISS recommendations with respect to approving a stock option plan take into account the value of the shares that can be issued under the new plan (in conjunction with shares that can be issued under any preexisting plans) as compared to certain benchmark data developed by ISS using ISS's "proprietary SVT [shareholder value transfer] model . . . based on regression equations that take into account a company's market cap, industry, and performance indicators with the strongest correlation to long-term performance." We will not be surprised if some registrants argue the requirement to disclose "business methodology" means that ISS must disclose additional data with regard to its benchmarking process, since current disclosures are inadequate for a registrant to determine how the calculations are being made.

## Technical Issues

While not the focus of this alert, a key component of the SEC's release is its amendment of the proxy solicitation rules to codify its interpretation that a proxy solicitation includes the providing of voting recommendations by a person who markets its expertise as a provider of such advice and sells such advice for a fee. Litigation is underway challenging the SEC's authority to interpret the Securities Exchange Act of 1934 in a way that treats proxy advice the same as a proxy solicitation. The SEC's formal amendment of its regulations to reflect its view will undoubtedly have some influence on the litigation.

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