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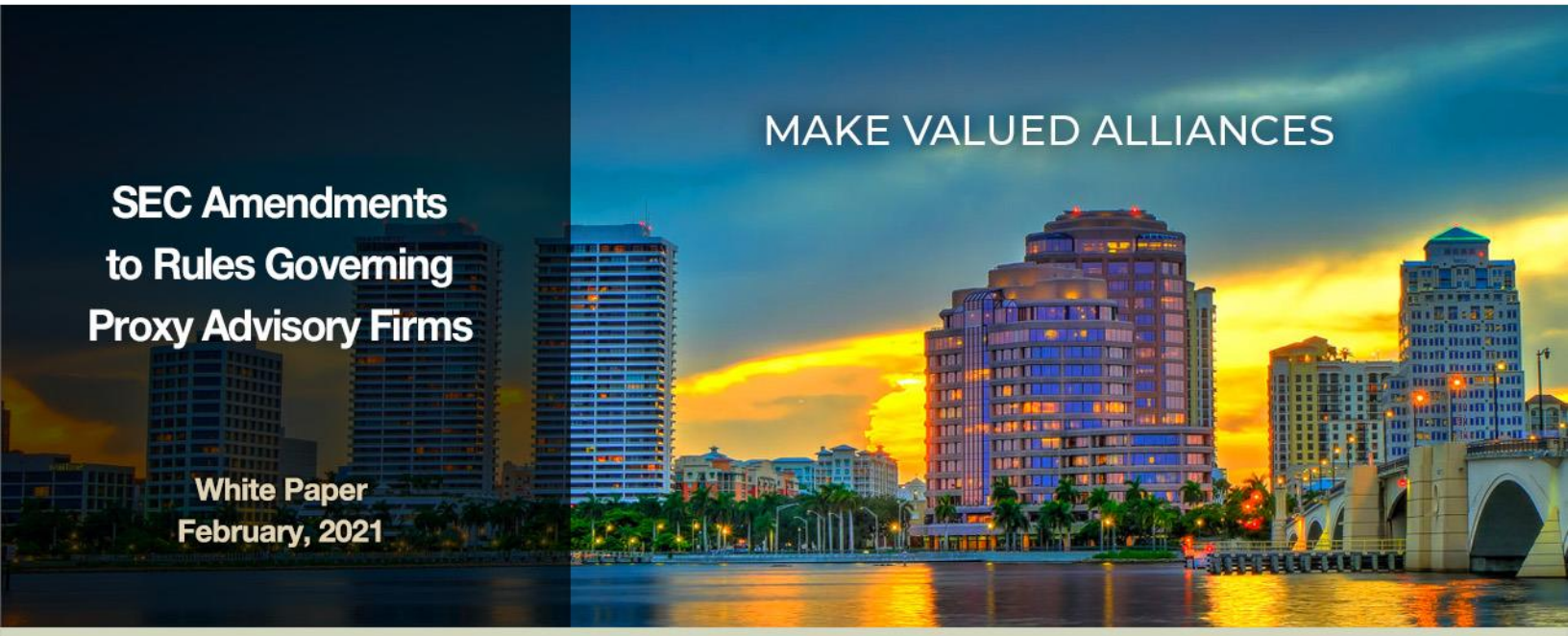

SEC Amendments to Rules Governing Proxy Advisory Firms

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SEC Amendments to Rules Governing Proxy Advisory Firms

In a year of numerous regulatory amendments and proposals, COVID-newsworthy capital markets events, and endless related topics, and with only one blog a week, this one is a little behind, but with proxy season looming, it is timely nonetheless. In July 2020, the SEC adopted controversial final amendments to the rules governing proxy advisory firms. The proposed rules were published in November 2019. The final rules modified the proposed rules quite a bit to add more flexibility for proxy advisory businesses in complying with the underlying objectives of the rules.

The final rules, together with the amendments to Rule 14a-8 governing shareholder proposals in the proxy process, which were adopted in September 2020, will see a change in the landscape of this year's proxy season for the first time in decades. However, certain aspects of the new rules are not required to be complied with until December 1, 2021.

The SEC has been considering the need for rule changes related to proxy advisors for years as retail investors increasingly invest through funds and investment advisors, in which the asset managers rely on the advice, services and reports of proxy voting advice businesses. It is estimated that between 70% and 80% of the market value of U.S. public companies is held by institutional investors, the majority of which use proxy advisory firms to manage the decision making and logistics of voting for thousands of proposals within a concentrated period of a few months. Proxy voting advice businesses provide a variety of services including research and analysis on matters to be voted upon; general voting guidelines that clients can adopt; giving specific voting recommendations on specific matters subject to a shareholder vote; and handling the administrative process of returning proxies and casting votes. The administrative tasks are usually electronic and, at times, can involve an automated completion of a ballot based on programed voting instructions.

The final vote was divided with the SEC Commissioners voting 3-1 in favor of the new rules. On the same day the SEC Commissioners, also in a 3-1 divided vote, endorsed guidance to investment advisors related to the new rules. The guidance updates the prior guidance issued in August 2019.

In essence, the amendments condition the availability of two exemptions from the information and filing requirements of the federal proxy rules, which are often used by proxy voting advice businesses, on compliance with tailored and comprehensive conflicts of interest disclosure requirements. In addition, the exemptions are conditioned on the requirements that (i) companies that are the subject of proxy voting advice have that advice made available to them in a timely manner; and (ii) clients of proxy advice businesses are made aware of a company's response to the advice in a timely manner.

The amendments codify the SEC's longstanding view that proxy advice constitutes a solicitation under the proxy rules and is thus subject to the anti-fraud provisions. In particular, the amendment changes the definition of "solicitation" in Exchange Act Rule 14a-1(l) to specifically include proxy advice subject to certain exceptions, provides additional examples for compliance with the anti-fraud provisions in Rule 14a-9 and amends rule 14a-2(b) to specifically exempt proxy voting advice businesses from the filing and information requirements of the federal proxy rules.

Rule 14a-1(l) – Definition of "Solicit" and "Solicitation"

The federal proxy rules can be found in Section 14 of the Securities Exchange Act of 1934 ("Exchange Act") and the rules promulgated thereunder. The rules apply to any company which has securities registered under Section 12 of the Act. Exchange Act Rule 14(a) makes it unlawful for any person to "solicit" a proxy unless they follow the specific rules and procedures. Prior to the amendment, Rule 14a-1(l), defined a solicitation to include, among other things, a "communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy," and includes communications by a person seeking to influence the voting of proxies by shareholders, regardless of whether the person himself/herself is seeking authorization to act as a proxy. The SEC's August 2019 guidance confirmed that proxy voting advice by a proxy advisory firm would fit within this definition of a solicitation and the new amendment codified such view.

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The amendments change Rule 14a-1(l) to specify the circumstances when a person who furnishes proxy voting advice will be deemed to be engaged in a solicitation subject to the proxy rules. In particular, the definition of "solicit" or "solicitation" now includes "any proxy 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 such advice for a fee."

The SEC provides for certain exemptions to the definition of a "solicitation" including: (i) the furnishing of a form of proxy to a security holder upon the unsolicited request of such security holder as long as such request is not to a proxy advisory firm; (ii) the mailing out of proxies for shareholder proposals, providing shareholder lists or other company requirements under Rule 14a-7 related to shareholder proposals; (iii) the performance by any person of ministerial acts on behalf of a person soliciting a proxy; or (iv) a communication by a security holder, who does not otherwise engage in a proxy solicitation, stating how the security holder intends to vote and the reasons therefor. This last exemption is only available, however, if the communication: (A) is made by means of speeches in public forums, press releases, published or broadcast opinions, statements, or advertisements appearing in a broadcast media, or newspaper, magazine or other bona fide publication disseminated on a regular basis, (B) is directed to persons to whom the security holder owes a fiduciary duty in connection with the voting of securities of a registrant held by the security holder (such as financial advisor), or (C) is made in response to unsolicited requests for additional information with respect to a prior communication under this section.

By maintaining a broad definition of a solicitation, the SEC can exempt certain communications, as it has in the definition, in Rule 14a-2(b) discussed below, and through no-action relief, while preserving the application of the anti-fraud provisions. In that regard, the amended SEC rules specifically state that a proxy advisory firm does not fall within the carve-out in Rule 14a1(l) for "unsolicited" voting advice where the proxy advisory firm is hired by an investment advisor to provide advice. Proxy advisory firms do much more than just answer client inquiries, but rather market themselves as having an expertise in researching and analyzing proxies for the purpose of making a voting determination.

On the other hand, in response to commenters, the new rule adds a paragraph to specifically state that the terms "solicit" and "solicitation" do not include any proxy voting advice provided by a person who furnishes such advice only in response to an unprompted request. For example, when a shareholder reaches out to their financial advisor or broker with questions related to proxies, the financial advisor or broker would be covered by the carve-out for unsolicited inquiries.

In response to commenters from the proposing release, the SEC also clarified that a voting agent that does not provide voting advice, but rather exercises delegated voting authority to vote shares on behalf of its clients, would not be providing "voting advice" and therefore would not be encompassed within the new definition of "solicitation."

Rule 14a-2(b) – Exemptions from the Filing and Information Requirements

Subject to certain exemptions, a solicitation of a proxy generally requires the filing of a proxy statement with the SEC and the mailing of that statement to all shareholders. Proxy advisory firms can rely on the filing and mailing exemption found in Rule 14a-2(b) if they comply with all aspects of that rule. Rule 14a-2(b)(1) provides an exemption from the information and filing requirements for "[A]ny solicitation by or on behalf of any person who does not, at any time during such solicitation, seek directly or indirectly, either on its own or another's behalf, the power to act as proxy for a security holder and does not furnish or otherwise request, or act on behalf of a person who furnishes or requests, a form of revocation, abstention, consent or authorization." The exemption in Rule 14a-2(b)(1) does not apply to affiliates, 5% or greater shareholders, officers or directors, or director nominees, nor does it apply where a person is soliciting in opposition to a merger, recapitalization, reorganization, asset sale or other extraordinary transaction or is an interested party to the transaction.

Rule 14a-2(b)(3) generally exempts voting advice furnished by an advisor to any other person the advisor has a business relationship with, such as broker-dealers, investment advisors and financial analysts. The amendment adds conditions for a proxy advisory firm to rely on the exemptions in Rules 14a-2(b)(1) or (b)(3).

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The amendments add new Rule 14a-2(b)(9) providing that in order to rely on an exemption, a proxy voting advice business would need to: (i) include disclosure of material conflicts of interest in their proxy voting advice; and (ii) have adopted and publicly disclosed written policies and procedures design to (a) provide companies and certain other soliciting persons with the opportunity to review and provide feedback on the proxy voting advice before it is issued, with the length of the review period depending on the number of days between the filing of the definitive proxy statement and the shareholder meeting; and (b) provide proxy advice business clients with a mechanism to become aware of a company's written response to the proxy voting advice provided by the proxy firm, in a timely manner.

The new rules contain exclusions from the requirements to comply with new Rule 14a-2(b)(9). A proxy advisory business would not have to comply with new Rule 14a-2(b)(9) for proxy voting advice to the extent such advice is based on an investor's custom policies – that is, where a proxy advisor provides voting advice based on that investor's customized policies and instructions. In addition, a proxy advisory business would not need to comply with the rule if they provide proxy voting advice as to non-exempt solicitations regarding (i) mergers and acquisition transactions specified in Rule 145(a) of the Securities Act; or (ii) by any person or group of persons for the purpose of opposing a solicitation subject to Regulation 14A by any other person or group of persons (contested matters). The SEC recognizes that contested matters or some M&A transactions involve frequent changes and short time windows. This exception from the requirements of Rule 14a-2(b)(9) applies only to the portions of the proxy voting advice relating to the applicable M&A transaction or contested matters and not to proxy voting advice regarding other matters presented at the meeting.

New Rule 14a-2(b)(9) is not required to be complied with until December 1, 2021. Solicitations that are exempt from the federal proxy rules' filing requirements remain subject to Exchange Act Rule 14a-9, which prohibits any solicitation from containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact.

Conflicts of Interest

The rule release provides some good examples of conflicts of interest that would require disclosure, including: (i) providing proxy advice to voters while collecting fees from the company for advice on governance or compensation policies; (ii) providing advice on a matter in which one of its affiliates or other clients has a material interest, such as a transaction; (iii) providing voting advice on corporate governance standards while at the same time working with the company on matters related to those same standards; (iv) providing voting advice related to a company where affiliates of the proxy advisory business hold major shareholder, board or officer positions; and (v) providing voting advice to shareholders on a matter in which the proxy advisory firm or its affiliates had provided advice to the company regarding how to structure or present the matter or the business terms to be offered.

The prior rules did generally require disclosure of material interests, but the amended rules require a more specific and robust disclosure. The amended rules require detailed disclosure of: (i) any information regarding an interest, transaction or relationship of the proxy voting advice business or its affiliates that is material to assessing the objectivity of the proxy voting advice in light of the circumstances of the particular interest, transaction or relationship; and (ii) any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction or relationship. The final rule, as written, reflects a principles-based approach and adds more flexibility to the proxy advisory business than the more prescriptive-based rule proposal.

Although the rule requires prominent disclosure of material conflicts of interest to ensure the information is readily available, it provides flexibility in other respects. The rule does not dictate the particular location or presentation of the disclosure in the advice or the manner of its conveyance as some commenters recommended. Accordingly, the rule would give a proxy voting advice business the option to include the required disclosure either in its proxy voting advice or in an electronic medium used to deliver the proxy voting advice, such as a client voting platform, which allows the business to segregate the information, as necessary, to limit access exclusively to the parties for which it is intended. Likewise, the disclosure of policies and procedures related to conflicts of interest is flexible. This may include, for example, a proxy voting advice business providing an active hyperlink or "click-through" feature on its platform allowing clients to quickly refer from the voting advice to a more comprehensive description of the business's general policies and procedures governing conflicts of interest.

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Review and Feedback on Proxy Advisory Materials

Although some of the largest proxy advisory firms, such as ISS and Glass Lewis, voluntarily provide S&P 500 companies with an opportunity to review and provide some feedback on advice, there is still a great deal of concern as to the accuracy and integrity of advice, and the need to formally allow all companies and soliciting parties an opportunity to review and provide input on such advice prior to it being provided to solicitation clients. Likewise, it is equally important that clients learn of written feedback and responses to a proxy advisor's advice. The amended rules are designed to address the concerns but as adopted are more principles-based and less prescriptive than the proposal.

The proposed amendments would have required a standardized opportunity for timely review and feedback by companies and third parties and require specific disclosure to clients of written responses. The time for review was set as a number of days based on the date of filing of the definitive proxy statement. However, commenters pushed back and the SEC listened.

The final rules allow proxy advisory businesses to take matters into their own hands. In particular, a proxy voting advice business must adopt and publicly disclose written policies and procedures reasonably designed to ensure that (i) companies that are the subject of proxy voting advice have such advice made available to them at or prior to the time when such advice is disseminated to the proxy voting advice business's clients; and (ii) the proxy voting advice business provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by companies that are the subject of such advice, in a timely manner before the shareholder meeting (or, if no meeting, before the votes, consents, or authorizations may be used to effect the proposed action).

As adopted, the new rule does not dictate the manner or specific timing in which proxy voting advice businesses interact with companies, and instead leaves it within the discretion of the proxy voting advice business to choose how best to implement the principles embodied in the rule and incorporate them into the business's policies and procedures. Although advice does not need to be provided to companies prior to be disseminated to proxy voting business's clients, it is encouraged where feasible. Under the final rules, companies are not entitled to be provided copies of advice that is later revised or updated in light of subsequent events.

New Rule 14a-2(b)(9) provides a non-exclusive safe harbor in which a proxy advisory firm could rely upon to ensureAmazon.com Inc. stock outperforms market on strong trading day- Amazon that its written policies and procedures satisfy the rule. In particular:

(i) If its written policies and procedures are reasonably designed to provide companies with a copy of its 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 companies to (a) file their definitive proxy statement at least 40 calendar days before the security holder meeting and (b) 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 companies' employees or advisers.

(ii) If its written policies and procedures are reasonably designed to provide notice on its electronic client platform or through email or other electronic means that the company has filed, or has informed the proxy voting advice business that it intends to file, additional soliciting materials setting forth the companies' statement regarding the advice (and include an active hyperlink to those materials on EDGAR when available).

The safe harbor allows a proxy advisory firm to obtain some assurances as to the confidentiality of information provided to a company. Policies and procedures can require that a company limit use of the advice in order to receive a copy of the proxy voting advice. Written policies and procedures may, but are not required to, specify that companies must first acknowledge that their use of the proxy voting advice is restricted to their own internal purposes and/or in connection with the solicitation and will not be published or otherwise shared except with the companies' employees or advisers.

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It is not a condition of this safe harbor, nor the principles-based requirement, that the proxy voting advice business negotiate or otherwise engage in a dialogue with the company, or revise its voting advice in response to any feedback. The proxy voting advice business is free to interact with the company to whatever extent and in whatever manner it deems appropriate, provided it has a written policy that satisfies its obligations.

Rule 14a-9 – the Anti-Fraud Provisions

All solicitations, whether or not they are exempt from the federal proxy rules' filing requirements, remain subject to Exchange Act Rule 14a-9, which prohibits any solicitation from containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact. The amendments modify Rule 14a-9 to include examples of when the failure to disclose certain information in the proxy voting advice could, depending upon the particular facts and circumstances, be considered misleading within the meaning of the rule.

The types of information a proxy voting advice business may need to disclose include the methodology used to formulate the proxy voting advice, sources of information on which the advice is based, or material conflicts of interest that arise in connection with providing the advice, without which the proxy voting advice may be misleading. Currently the Rule contains four examples of information that may be misleading, including: (i) predictions as to specific future market values; (ii) information that impugns character, integrity or personal reputation or makes charges concerning improper, illegal or immoral conduct; (iii) failure to be clear as to who proxy materials are being solicited by; and (iv) claims made prior to a meeting as to the results of a solicitation.

The new rule adds to these examples the information required to be disclosed under 14a2-(b), including the failure to disclose the proxy voting advice business's methodology, sources of information and conflicts of interest. The proxy advisor must provide an explanation of the methodology used to formulate its voting advice on a particular matter, although the requirement to include any material deviations from the provider's publicly announced guidelines, policies, or standard methodologies for analyzing such matters, was dropped from the proposed rule. The SEC uses as an example a case where a proxy advisor recommends a vote against a director for the audit committee based on its finding that the director is not independent while failing to disclose that the proxy advisor's independence standards differ from SEC and/or national exchange requirements and that the nominee does in fact meet those legal requirements.

Likewise, a proxy advisor must make disclosure to the extent that the proxy voting advice is based on information other than the company's public disclosures, such as third-party information sources, disclosure about these information sources and the extent to which the information from these sources differs from the public disclosures provided by the company.

Supplemental Guidance for Investment Advisors

On the same day as enacting the amended rules the SEC Commissioners, also in a 3-1 divided vote, endorsed supplemental guidance for investment advisors in light of the new rules. The guidance updates the prior guidance issued in August 2019. The supplemental guidance assists investment advisers in assessing how to consider company responses to recommendations by proxy advisory firms that may become more readily available to investment advisers as a result of the amendments to the solicitation rules under the Exchange Act.

The supplemental guidance states that an investment adviser should have policies and procedures to address circumstances where the investment adviser becomes aware that a company intends to file or has filed additional soliciting materials with the SEC, after the investment adviser has received the proxy advisory firm's voting recommendation but before the submission deadline. The supplemental guidance also addresses disclosure obligations and client consent when investment advisers use automated services for voting such as when they receive pre-populated ballots from a proxy advisory services firm.

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Palm Beach securities attorney Laura Anthony and her experienced legal team provide ongoing corporate counsel to small and mid-size private companies, OTC and exchange traded public companies as well as private companies going public on the Nasdaq, NYSE American or over-the-counter market, such as the OTCQB and OTCQX. For more than two decades Anthony L.G., PLLC has served clients providing fast, personalized, cutting-edge legal service. The firm's focus includes, but is not limited to Regulation D and Regulation S and PIPE Transactions, securities token offerings and initial coin offerings, Regulation A/A+ offerings, as well as registration statements on Forms S-1, S-3, S-8 and merger registrations on Form S-4; compliance with the Securities Exchange Act of 1934, including registration on Form 10, reporting on Forms 10-Q, 10-K and 8-K, and 14C Information and 14A Proxy Statements; all forms of going public transactions; mergers and acquisitions including both reverse mergers and forward mergers; applications to and compliance with the corporate governance requirements of securities exchanges including Nasdaq and NYSE American. Palm Beach attorney Laura Anthony is also the author of SecuritiesLawBlog.com, the producer and host of LawCast.com, Corporate Finance in Focus, and a contributor to The Huffington Post and Law360.

Ms. Anthony is involved throughout the community of Palm Beach. She is on the board of directors for the American Red Cross for Palm Beach and Martin Counties, and provides financial support to the Susan Komen Foundation, Opportunity, Inc., New Hope Charities, the Society of the Four Arts, the Norton Museum of Art, Palm Beach County Zoo Society, the Kravis Center for the Performing Arts and several other organizations. She is also a financial and hands-on supporter of Palm Beach Day Academy, one of Palm Beach's oldest and most respected educational institutions. She currently resides in Palm Beach with her husband and daughter.

Ms. Anthony is an honors graduate from Florida State University College of Law and has been practicing law since 1993.

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