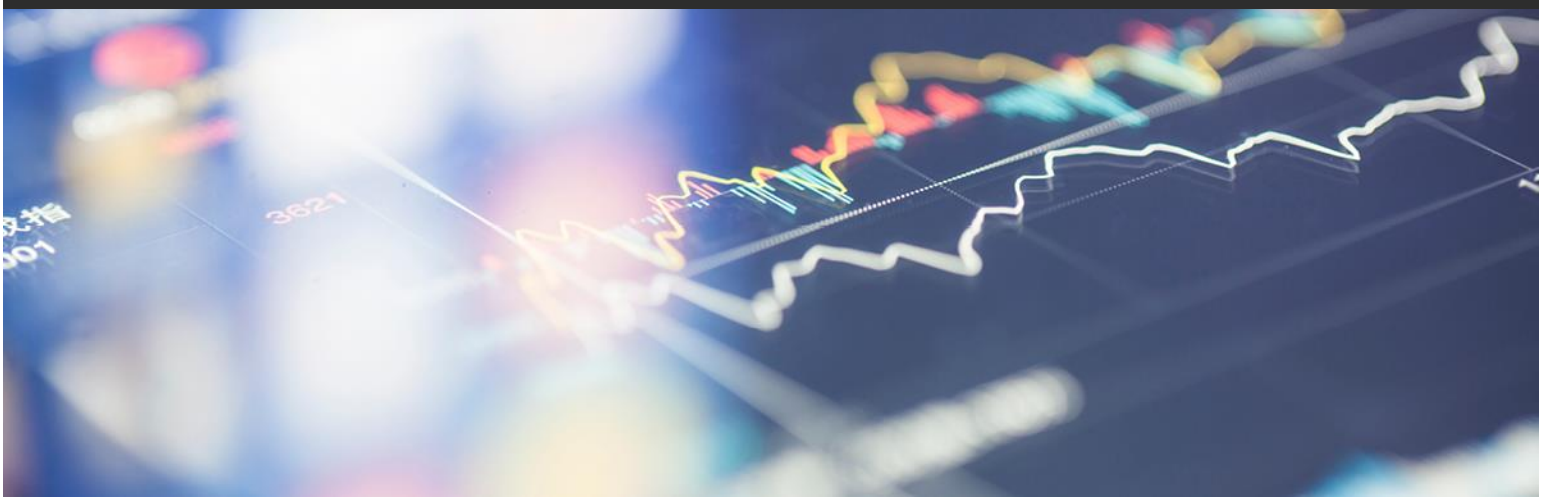
GT GreenbergTraurig

Alert | Financial Regulatory & Compliance



August 2020

The SEC's 2020 Amendments to Proxy Rules and Supplemental Guidance to Investment Advisers on Proxy Voting Responsibilities

Background

Proxy advisory firms (Proxy Firms) have long provided institutional investors advice and recommendations with respect to management and shareholder proxy proposals. In recent years, the Securities and Exchange Commission (SEC) has expressed concerns over the accuracy, process, and conflicts of interests that may affect such advice and recommendations. Consequently, the SEC proposed amendments to the federal proxy rules in November 2019 which would have required that Proxy Firms maintain a review process allowing issuers an opportunity to comment on advice before its dissemination. However, the SEC pulled back on this proposed requirement after the two leading Proxy Firms (ISS and Glass Lewis) pointed out many burdens of such a review process. In its stead, on July 22, 2020, the SEC adopted a set of principle-based rules for Proxy Firms, as described below.

The New Proxy Rules

The amendments adopted by the SEC require Proxy Firms to take certain action to rely on a statutory exemption from the information and filing requirements of federal proxy rules. Most importantly, the new rules require that Proxy Firms provide to affected parties: (i) disclosure of any material conflicts of interest (information regarding an interest, transaction, or relationship that is material to assessing the

objectivity of the proxy voting advice); and (ii) public disclosure of written policies and procedures that it uses to: (a) identify material conflicts of interest; (b) ensure that issuers have access to proxy advice before or at the same time as it is provided to clients; and (c) ensure advice is provided to clients in a timely manner with a mechanism to make them aware of issuer input.

To comply with the last requirement, a Proxy Firm may utilize a safe harbor by providing notice on its electronic client platform (or via other electronic methods) that the issuer has filed (or is aware that the issuer intends to file) additional soliciting materials. Issuers should consider how to make proxy advisers aware where appropriate.

Furthermore, a Proxy Firm may condition its obligation to ensure that issuers have access to proxy advice before or at the same time it is provided to clients on the relevant issuer (i) agreeing to file its definitive proxy statement at least 40 calendar days before the relevant shareholder meeting and (ii) expressly acknowledging that it will use the voting advice only for internal purposes and share the advice only with its employees and advisers.

In addition, the SEC amended Rule 14a-9 under the Securities and Exchange Act of 1934 to include examples of when a Proxy Firm's failure to disclose certain material information in its advice would be considered misleading. This amendment raises liability concerns for Proxy Firms.

Investment Adviser Supplemental Guidance

Concurrently with the proxy amendments, the SEC provided additional guidance with respect to investment advisers and their duties under the new rules. The new guidance is a continuation of the SEC's September 2019 publication, *Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*. This previous guidance assisted investment advisers in outsourcing proxy decisions to Proxy Firms while still fulfilling their fiduciary duties to clients by recommending that investment advisers (i) conduct reasonable due diligence with respect to each proxy matter and (ii) recognize and respond to conflicts of interests and provide full disclosures of such conflicts. Additionally, the previous guidance recommended that investment advisers carefully monitor and analyze Proxy Firm methodology and processes and review their engagements with issuers.

The new guidance highlights the need for investment advisers to review, and develop procedures to review, issuer responses to proxy advice as contemplated by the amendments. This is particularly important where automated voting processes are used. Automation is a risk to the detailed due diligence required of both proxy recommendations and issuer responses. "An investment adviser should consider, for example, whether its policies and procedures address circumstances where the investment adviser has become aware that an issuer 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." In this case, the investment adviser needs to consider such information prior to exercising voting authority to demonstrate that it is voting in each client's best interest.

Considering the above, the SEC recommends that investment advisers that use automated voting should disclose: (1) the extent of their use of automated voting; and (2) how its policies and procedures address the use of automated voting in cases where it becomes aware that an issuer intends to file or has filed additional soliciting materials.

Conclusion

The SEC's new rules significantly impact proxy services. There is currently a divide between regulators and Proxy Firms with respect to whether this impact is positive or negative. On one hand, SEC Commissioner Elad L. Roisman believes that the new proxy rules "bring improvements to the status quo for investors and our markets." On the other hand, ISS President Gary Retelny believes that the new rules "serve as a blow to institutional investors seeking to judiciously monitor portfolio companies."

It remains to be seen how the new rules will be enforced in practice. In any case, the alleged practice of "set-it-and-forget-it," as highlighted by Mr. Roisman, or any other process that fosters pure automation to the proxy process, should be avoided by both institutional investors and investment advisers.

Authors

This GT Alert was prepared by:

- Arthur Don | +1 312.456.8438 | dona@gtlaw.com
- Vincent Lewis | +1 312.456.8451 | lewisv@gtlaw.com

Additional Financial Regulatory & Compliance Practice Contacts including:

- Steven M. Felsenstein | +1 215.988.7837 | felsensteins@gtlaw.com
- Richard M. Cutshall ‡ | +1 303.572.6527 | cutshallr@gtlaw.com

‡ Licensed in the State of Illinois; practice temporarily authorized in the State of Colorado pending admission under C.R.C.P. 205.6.