

## [Securities Regulation Daily Wrap Up, TOP STORY—SEC to reexamine Clayton-era rules on proxy advisory firms, \(Jun. 1, 2021\)](#)

Securities Regulation Daily Wrap Up

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Chair Gary Gensler indicated that recommendations from SEC staff may result in regulatory action regarding proxy advisory firms possibly differing from the approach of his predecessor.

The SEC's Division of Corporation Finance issued a [statement](#) advising that the staff, at the direction of Chair Gary Gensler, is considering revisiting its 2019 interpretive guidance and 2020 rule amendments on proxy advisory firms. The rule amendments, which codified the Commission's view that proxy voting advice generally constitutes a "solicitation" and adopted new conditions to exemptions from the proxy rules' information and filing requirements on proxy voting advice, have been criticized by proxy advisory firms and shareholder advocates but welcomed by issuers and the more market-friendly commissioners on the SEC.

**Proxy advisory firms: 2019 guidance and 2020 rule.** The Commission began exploring reforms to the U.S. proxy system in 2018 with a series of roundtable discussions on several issues, including "proxy plumbing" (reforming the proxy voting infrastructure), issues facing proxy advisory firms, and revisiting the ownership thresholds for submitting and resubmitting shareholder proposals. Testimony at the proxy advisor [roundtable](#) included views from the two large proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis, who defended their work as executing the best interests and the wishes of their clients.

The roundtable also heard from investment advisers, who praised the work of proxy advisory firms that can do in-depth analysis and provide reports that advisers are unable to do themselves. However, smaller proxy advisory firms warned of the barriers to entry to the industry given the influence of ISS and Glass Lewis as well as potential conflicts of interest when proxy advisor firms delve into the consulting industry. Issuer representatives also noted that when a proxy advisory firm makes an error in its report on an issuer, it is difficult to go about correcting it.

The Commission eventually used input from the roundtable and comment letters to conduct a series of rulemakings on the SEC's proxy rules, including those affecting proxy advisory firms. In August 2019, the SEC approved by a 3-to-2 vote an [interpretation](#) regarding proxy voting advisers. The interpretation states that proxy voting advice provided by proxy advisory firms generally constitutes a "solicitation" under the federal proxy rules and provided related guidance about the application of the proxy antifraud rule to proxy voting advice. In opposing the interpretation and the guidance, Commissioner Allison Herren Lee and then-Commissioner Robert Jackson cited the lack of a notice and comment period, with Lee [lamenting](#) that it would introduce costs and additional pressure into the already condensed proxy season and could increase issuer involvement in the process, potentially undermining the independence of voting recommendations.

In July 2020, the Commission [approved](#), by a 3-to-1 vote, rule amendments on proxy voting advice and new supplemental guidance. While the [adopted](#) rules were less stringent than the proposed rules, which would have required that businesses that provide proxy voting advice furnish their advice to issuers to review for factual errors or methodological weaknesses before providing the report to the firm's clients, the rule still met opposition from Commissioner Lee, who reiterated her earlier arguments that the rules try to fix a system that is not broken.

Commissioner Elad Roisman, who had been tasked by then-Chairman Jay Clayton with leading the SEC's efforts to reform its proxy rules, defended the rulemaking. According to Roisman, the new rules ensure that registrants and proxy advisers' clients will have access to proxy advice at the same time and that clients will

have access to registrants' responses to such proxy advice before they vote as well as providing consistent standards for conflict of interest disclosure.

Regarding proxy advice transparency, the Rule 14a-1(l) was amended to codify the view that proxy voting advice generally constitutes a solicitation. They also amended Rules 14a-2(b)(1) and (b)(3), which provide exemptions from the information and filing requirements of the proxy rules to require more conflicts of interest disclosure. In addition, the amendments modified Rule 14a-9 to include examples of when the failure to disclose certain material information in proxy voting advice could be considered misleading.

**Criticism and lawsuits.** The proxy advisory rule has been subject to criticism by the SEC's own Investor Advisory Committee (IAC) and has been litigated in a lawsuit brought against the SEC by ISS. A [recommendation](#) by the IAC dated January 16, 2020, criticized the proxy advisor proposal (which had not yet been approved as a final rule by the SEC) as being unbalanced and not in compliance with the SEC's own cost-benefit analysis policy. John Coates, then-chair of the IAC's Investor-as-Owner Subcommittee and currently the acting director of the SEC's Division of Corporation Finance, [spoke](#) in favor of revamping the rules at that meeting, stating that there are more important reforms to be made in the proxy system, such as counting votes reliably. Echoing a sentiment expressed by Commissioner Lee, Coates had also expressed his concern that the proposal did not identify any particular issue that needed to be addressed.

A few months after the SEC approved the new proxy advisory firm rules, ISS sued the SEC seeking declaratory and injunctive relief against the regulations, stating that they impose several burdensome new obligations on proxy advisers by injecting corporate issuers into proxy advice by requiring proxy advisers to share their recommendations and analyses with issuers and imposing potential liability under Rule 14a-9 for alleged misstatements or omissions in proxy advice. The Council of Institutional Investors (CII) [filed](#) an [amicus brief](#) in support of ISS's lawsuit, citing the Commission's "deficient justifications" for the amended rules and accusing it of "blithely concoct[ing] a new justification for its predetermined course of action, ignoring the radical diminution of benefits inherent in shifting goals from avoiding purported material errors in advice to a milquetoast commitment to 'fostering dialogue.'"

**Change in SEC policy.** In the latest statement from CorpFin, the staff notes that at the direction of Chair Gary Gensler, the Division is considering whether to recommend that the SEC revisit the 2019 interpretive guidance and the 2020 rule amendments regarding proxy voting advice. The Division will not recommend enforcement action to the Commission based on either the interpretive guidance or the rule amendments during this period. The CorpFin statement notes that proxy advisory firms subject to the rules are not required to comply with the new conditions under Rule 14a-2(b)(9) until December 1, 2021, but in the event these conditions remain in place by that date, the staff will not recommend any enforcement action based on those conditions for a reasonable period of time after any resumption of the ISS lawsuit.

In a short [statement](#), Chair Gensler remarked: "I am now directing the staff to consider whether to recommend further regulatory action regarding proxy voting advice. In particular, the staff should consider whether to recommend that the Commission revisit its 2020 codification of the definition of solicitation as encompassing proxy voting advice, the 2019 Interpretation and Guidance regarding that definition, and the conditions on exemptions from the information and filing requirements in the 2020 Rule Amendments, among other matters."

ISS president Gary Retelny [applauded](#) the SEC's action, stating that "We welcome the SEC's announced decision to consider revisiting its proxy adviser rulemaking, which we believe was ill-conceived, inconsistent with the law, and pushed through under the previous administration against the wishes of investors the agency is meant to protect."

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