New rules put pressure on proxy advisory firms to involve issuers in the proxy advice process

Recent amendments (the “Amendments”) to the U.S. Securities and Exchange Commission’s (the “SEC”) rules governing proxy solicitation (the “proxy rules”) will soon impose controversial new disclosure and liability requirements on companies (“proxy advisory firms”) that advise investment advisers and institutional investors on their voting determinations.

The advice provided by proxy advisory firms, such as Institutional Shareholder Services (“ISS”) and Glass Lewis & Co., is viewed as having a significant influence on shareholder voting, and many public companies and the U.S. Chamber of Commerce have advocated for greater regulation of such firms.

In general, the SEC’s proxy rules impose a number of onerous process and disclosure requirements, including the filing with the SEC of a proxy statement, on anyone who engages in a proxy solicitation. The Amendments define the terms “solicit” and “solicitation” to clarify that proxy voting advice generally constitutes a solicitation within the meaning of Section 14(a) of the U.S. Securities Exchange Act of 1934.

Under the Amendments, proxy advisory firms will be allowed to rely on an exemption to avoid the procedural and disclosure requirements, but only if they satisfy the following conditions:

> they must provide certain conflicts of interest disclosure in their proxy voting advice or in an electronic medium used to deliver the proxy voting advice; and

> they must adopt and publicly disclose written policies and procedures reasonably designed to ensure that:

  > the companies that are the subject of proxy voting advice have the advice made available to them at or prior to the time when the advice is disseminated to the proxy advisory firm’s clients; and

  > the proxy advisory firm provides its clients with a mechanism by which its clients can reasonably be expected to become aware of any written statements regarding the proxy voting advice by companies who are the subject of such advice, in a timely manner before the shareholder meeting.
As proposed last year, the rules would have required that proxy advisory firms provide draft versions of their proxy voting advice to companies for review and comment, before the advice was provided to the proxy advisory firms’ clients. The Amendments, however, permit proxy advisory firms to provide the final proxy voting advice to companies at the same time the advice is disseminated to clients, although they are encouraged to provide the voting advice to companies earlier.

The SEC has also amended Rule 14a-9, the antifraud provision of the proxy rules, to include examples of when the failure to disclose certain material information in proxy voting advice could be considered misleading. The examples include material information about the proxy advisory firm’s methodology, sources of information, or conflicts of interest.

Notably, in recent years, proxy advisory firms have begun issuing guidelines for measuring public companies based on environmental, social and governance (“ESG”) factors, which has put pressure on companies to pay attention to ESG issues, including ESG-related disclosure, which is not specifically mandated by SEC disclosure rules. The pressure may relent somewhat under the amended proxy rules, which actively promote company involvement in the proxy advice process and highlights the SEC’s interest in regulating proxy advisory firms.

These amendments to the proxy rules come not long after the U.S. Department of Labor (the “DOL”) proposed a new rule that would prevent employee benefit plans that are subject to the Employee Retirement Income Security Act of 1974 from pursuing “non-financial objectives,” including ESG objectives, if doing so puts returns or participants at risk.

These recent actions highlight the divergent approaches being taken in Europe and the United States with respect to ESG. While the UK and EU authorities have undertaken a concerted effort to introduce significant mandatory legal requirements to align companies with ESG goals, US federal regulators are pursuing policies that appear likely to impede the adoption of ESG goals.

The Amendments will be effective 60 days after publication in the Federal Register, but affected proxy advisory firms are not required to comply with the conditions for relying on the exemption from the proxy rule procedural and disclosure requirements until December 1, 2021.

In the meantime, it is possible that ISS will revive the lawsuit it filed last year challenging the SEC’s view that the proxy rules apply to the provision of proxy advice, which ISS agreed to pause pending adoption of the Amendments.

We will continue to monitor developments in this area and welcome any queries you may have.