

Investor Alert

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SEC'S AMENDMENT TO PROXY-ADVISORY RULES A WIN FOR VOTING INDEPENDENCE OF INSTITUTIONAL INVESTORS

On July 13, 2022, the Securities and Exchange Commission voted to adopt amendments to its rules governing proxy-voting advice,¹ voting to partially rescind a set of rules enacted during the Trump administration that “made it somewhat more difficult for investors to influence public companies via shareholder voting.”² The prior rules enacted in 2020 increased restrictions on proxy-voting advice firms (or “proxy-advisory firms”), which advise institutional investors on how to vote their shares in a proxy.³

In order to understand the significance of these recent amendments, one must first understand the role that proxy-advisory firms play and their relationship to institutional investors, including institutional investors who may wish to take a more activist role through shareholder voting.

Proxy-Advisory Firms

According to the SEC, “[o]ne of the defining characteristics of today’s market is the significant role played by institutional investors, which today own, by some estimates, between 70 and 80 percent of the

market value of U.S. public companies. Investment advisers voting on behalf of clients and other institutional investors, by virtue of their significant holdings (often on behalf of others, including retail investors) in many public companies, must manage the logistics of voting in potentially hundreds, if not thousands, of shareholder meetings and on thousands of proposals that are presented at these meetings each year, with the significant portion of those voting decisions concentrated in a period of a few months.”⁴ To that end, “[i]nvestment advisers and other institutional investors often retain proxy advisory firms to assist them in making their voting determinations on behalf of clients and to handle other aspects of the voting process.”⁵ Such proxy-advisory firms “typically provide institutional investors and other clients a variety of services that relate to the substance of voting, such as:

- [1] providing research and analysis regarding the matters subject to a vote;
- [2] promulgating general voting guidelines that their clients can adopt; and

¹Press Release, Securities and Exchange Commission, *SEC Adopts Amendments to Proxy Rules Governing Proxy Voting Advice* (July 13, 2022).

²Paul Kiernan and Michelle Chan, *SEC’s Gensler Casts Doubt on Prospects for China Audit Deal* (July 13, 2022).

³*Id.*

⁴*Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice* (proposed Dec. 4, 2019) (see also sources cited therein).

⁵*Id.*

[3] making voting recommendations to their clients on specific matters subject to a shareholder vote, either based on the [proxy-advisory firm's] own voting guidelines or on custom voting guidelines that the client has created.”⁶

The two largest proxy-advisory firms in the country (*i.e.*, Institutional Shareholder Services, Inc. and Glass Lewis & Co.) together serve more than 3,300 institutional clients, including the majority of the world's largest pension plans, mutual funds, and asset managers – who themselves collectively manage trillions of dollars in assets.⁷

The 2022 Rescission

On July 13, 2022, the SEC rescinded and eliminated two rules which were passed in 2020:

- ◆ requiring proxy-advisory firms to make their vote recommendations available to the public company no later than when the advice is disseminated to the proxy-advisor's clients; and
- ◆ requiring proxy-advisory firms to provide their clients with a “mechanism” for becoming aware of the public company's written

response to the proxy-advisory firm's recommendation – essentially requiring a proxy-advisory firm to provide the institutional investors with the company's response to their advice (together, the “2020 Rules”).

These former rules on the books served to enhance corporate management's influence in a proxy-battle by granting the company “advance access”⁸ to the proxy-advisory firm's recommendation, and by requiring that the proxy-advisory firms separately notify their clients of the company's response to their recommendations.

As such, under the 2020 Rules, institutional investors and proxy-advisory firms expressed concerns as to the independence of the investor's vote, as well as the potential for increased compliance costs for proxy-advisory firms and the timeliness of the recommendations they give. Indeed, upon the 2020 Rules' arrival, the Council for Institutional Investors (“CII”) stated that “we are concerned that the rules and guidance the SEC approved today could result in delays in distribution of proxy advice, driving up costs for investors, impairing the independence of proxy advice and causing uncertainty for institutional investors.”⁹

⁶*Id.*

⁷See [Proxy Voting Advice](#) (proposed Nov. 26, 2021); [Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice](#) (proposed Dec. 4, 2019) (footnote 18).

⁸Commissioner Allison Herren Lee, [Protecting the Independence of the Proxy Voting Process: Statement on Amendments Governing Proxy Voting Advice](#) (July 13, 2022).

⁹Press Release, Council of Institutional Investors, [Leading Investor Group Dismayed by SEC Proxy Advice Rules](#) (July 22, 2020).

In particular, the CII indicated that the primordial concern of the 2020 Rules was the decreased independence of proxy advice, aptly describing the process as one where:

“proxy advisory firms *may feel pressure to tilt voting recommendations in favor of management* more often, to avoid critical comments from companies that could draw out the voting process and expose the firms to costly threats of litigation.”¹⁰

With respect to the latter point, the CII indicated that companies—upon review of the advice recommended by the proxy-advisory firms—may not agree with the proxy-advisor’s methodology or recommendation, driving increased exposure to potential litigation. The end result is that the “independence and objectivity of proxy voting advice could be jeopardized.”¹¹ According to the CII, institutional investors—as primary customers of the proxy-advisory firms—did not support nor request the 2020 Rules.¹²

Significance of the Amendments

The SEC’s rescission of the 2020 Rules should thus place at ease these concerns by institutional investors and proxy-advisory firms. Moving forward, and as it relates to the voting recommendations, future proxy-

battles will likely revert to pre-2020 dynamics in terms of the mechanics of proxy-voting and the overall independence of institutional investors and the proxy-advisory firms they choose to hire. While the amendments seemingly only appear to be a “procedural” win in proxy-voting methodology, the overall decreased cost and hassle, and, importantly, increased independence and less corporate oversight, affords institutional investors substantive benefits during any proxy-contest that may occur.

The SEC’s most recent actions, however, may hold special significance and implications for activist investors who may wish to use shareholder proposals and proxy-contests to “nudge”¹³ company executives to consider certain issues, especially within the ESG arena (*i.e.*, Environmental, Social, and Corporate Governance). As one representative for a prominent pension fund indicated: “these are mechanisms through which we and other shareowners have pushed for antidiscrimination policies, greater diversity in the C-suite and boardroom, better climate policies and improved transparency.”¹⁴ Shareholder proposals and the accompanying proxy contests have been a significant source of such activism, as most notably

¹⁰*Id.* (emphasis added)

¹¹*Id.*

¹²Press Release, Council of Institutional Investors, [Leading Investor Group Applauds SEC Rollback of Onerous Proxy Advice Rules](#) (July 13, 2022).

¹³Paul Kiernan, *Wall Street Journal*, [“SEC Raises Bar for Shareholder Resolutions”](#) (Sept. 23, 2020).

¹⁴*Id.*

seen with last year's Engine No. 1 victory against Exxon Mobil that successfully placed 3 members on the Exxon Board.¹⁵ Increased independence and less corporate oversight for investors voting on these proposals stands as a benefit to such activist activity.

Further, and more observationally-speaking, the SEC's recent elimination of the 2020 Rules, in conjunction with prior recent activity by the SEC (see, e.g., Labaton Sucharow LLP's Investor Alerts, [SEC Issues Proposed Rule Changes Addressing Climate-Related Information Disclosure to Investors](#)¹⁶ and [SEC's Universal Proxy Rules Benefit Shareholders](#)¹⁷), signals to the market a positive and investor-friendly wave of actions taken by the SEC under Chairman Gary Gensler. We expect that the SEC will continue this trend of activity and continue to implement significant changes in the coming future under the current administration.

Proxy Advice = Proxy Solicitation Continues Unchanged

Under Section 14(a) of the Securities Exchange Act, it is "unlawful for any person . . . in contravention of such rules and regulations as the Commission may prescribe . . . to solicit or to permit the use of his name to solicit

any proxy or consent or authorization in respect of any security . . ." 15 U.S.C. §78n(a). Together with Rule 14a-9,¹⁸ any person who thus "solicits" a proxy is subject to liability if the proxy contained a false or misleading misrepresentation(s) or omission(s). See *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976).

In July 2020, and in addition to the 2020 Rules discussed above, the SEC also codified the interpretation that those who provide proxy advice, including proxy-advisory firms, "nevertheless engage in solicitation when they communicate with shareholders in a manner reasonably calculated to 'result' in a proxy vote," and are therefore subject to liability under Rule 14a-9 and Section 14(a).¹⁹ This codification triggered a suit against the SEC, brought by the Institutional Shareholder Services, see *Institutional Shareholder Services, Inc. v. SEC*, No. 1:19-cv-3275 (D.D.C.), and the case remains ongoing as of the date of this writing. Oral arguments are scheduled for July 29, 2022. Notably, the CII, on behalf of institutional investors, filed a joint amicus brief supporting the Institutional Shareholder Services, arguing that the amendments to

¹⁵Svea Herbst-Bayliss, *Reuters*, "[Little Engine No. 1 beat Exxon with just \\$12.5 mln](#)" (June 29, 2021).

¹⁶Eric Belfi and James M. Fee, [Labaton Sucharow LLP Investor Alert](#) (March 29, 2022).

¹⁷Eric Belfi, Lara Goldstone, and Philip J. Leggio, [Labaton Sucharow LLP Investor Alert](#) (December 3, 2021).

¹⁸17 CFR § 240.14a-9.

¹⁹[Exemptions From the Proxy Rules for Proxy Voting Advice](#) (effective November 2, 2020).

Rule 14a-9 “put at serious and unwarranted risk the continued availability of timely, high-quality, and independent advice and analysis of issues subject to shareholder vote.”²⁰

It should be noted that the recent July 13 rescission of the 2020 Rules that is the subject of this investor alert does not affect nor address this question of law, and investors should therefore be advised that currently, proxy advice from proxy-advisory firms would be considered proxy “solicitation” under the federal securities laws.²¹

Labaton Sucharow’s lawyers are available to address any questions you may have regarding these developments. Please contact the Labaton Sucharow lawyer with whom you usually work or the contacts below.

Domenico Minerva:

dminerva@labaton.com / 212.907.0887

David Saldamando:

dsaldamando@labaton.com / 212.907.0724

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²⁰*Institutional Shareholder Services, Inc. v. SEC*, No. 1:19-cv-3275 (D.D.C.) (ECF No. 24-1).

²¹See Press Release, Council of Institutional Investors, *Leading Investor Group Applauds SEC Rollback of Onerous Proxy Advice Rules* (July 13, 2022).