

MEMO# 32636

July 24, 2020

SEC Adopts Proxy Advice Rule Amendments and Supplemental Guidance for Investment Advisers

[32636]

July 24, 2020 TO: ICI Members

Investment Company Directors SUBJECTS: Compliance

Disclosure

Fund Governance

Intermediary Oversight

Investment Advisers

Operations

Transfer Agency RE: SEC Adopts Proxy Advice Rule Amendments and Supplemental Guidance for Investment Advisers

On July 22, the SEC adopted:

- amendments to its proxy rules related to proxy voting advice;[\[1\]](#) and
- supplemental proxy voting guidance for investment advisers.[\[2\]](#)

The SEC adopted each by a 3-1 vote, with Chairman Clayton and Commissioners Roisman and Peirce supporting each, and Commissioner Lee opposing each.[\[3\]](#)

With respect to the proxy voting advice amendments, the SEC adopted amendments to the “solicitation” definition and the proxy antifraud rule substantially as proposed. The SEC made substantial revisions its proposed “review and comment” framework for registrants, however. Whereas the proposal would have granted registrants the right to review and comment on proxy advisory firms’ *draft* advice *before* funds and other clients received it, the final amendments instead require that proxy advice be made available to registrants *at or prior to* dissemination to the proxy advisory firms’ clients. These amendments also exclude from the scope of these new review requirements proxy voting advice based on custom policies that are proprietary to a proxy advisory firm’s client.

The SEC’s new proxy voting guidance to investment advisers supplements its 2019 guidance to advisers, in light of the proxy advice rule amendments.

Summary of Proxy Voting Advice Amendments

Proxy advisory firms (or “proxy voting advice businesses” as they are called in the Adopting Release, and which we abbreviate herein as “PVABs”) provide proxy voting advice^[4] to institutional investors, including investment advisers and funds. The SEC adopted these amendments “so that investors who use proxy voting advice receive more transparent, accurate, and complete information on which to make their voting decisions, without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice.”^[5]

These amendments:

- Codify the SEC’s interpretation that proxy voting advice generally constitutes a “solicitation” within the meaning of the Securities Exchange Act of 1934;
- Condition the availability of certain existing exemptions from federal proxy rule requirements for PVABs upon compliance with additional disclosure and procedural requirements; and
- Amend the proxy antifraud rule to clarify when the failure to disclose certain information in proxy voting advice may be considered misleading.

We summarize each below.

Amended “Solicitation” Definition

In the Adopting Release, the SEC reiterates its view that proxy voting advice provided by PVABs generally constitutes a “solicitation” subject to the proxy rules. Rule 14a-1(l) as amended codifies this interpretation to make clear that the term “solicitation” 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 that markets its expertise as a provider of such advice, and sells such advice for a fee.^[6]

Amendments to the Solicitation Exemptions

Despite the SEC’s broad view of what constitutes a “solicitation,” Rule 14a-2(b) conditionally exempts certain solicitations or entities from the proxy rules’ information and filing requirements. PVABs currently rely on the exemptions in Rule 14a-2(b)(1) and (b)(3).

The amendments to Rule 14a-2(b) impose several new conditions on PVABs’ use of these exemptions. The SEC believes these new conditions will “advance the Commission’s interest in improving the mix of information available to shareholders in a manner that is compatible with the complex and time-sensitive proxy voting advice infrastructure that currently exists...”^[7]

First, the amendments require that PVABs include disclosure about material conflicts of interest in their proxy voting advice, or in an electronic medium used to deliver the proxy voting advice.^[8]

Second, PVABs must adopt and publicly disclose written policies and procedures reasonably designed to ensure that:

- Registrants^[9] 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

PVAB's clients;[\[10\]](#) and

- Clients have a mechanism by which they can reasonably be expected to become aware of any written statements regarding the PVAB's proxy voting advice by registrants, in a timely manner before the shareholder meeting.[\[11\]](#)

These provisions (particularly the first) depart significantly from the proposal, which would have granted registrants the right to review and comment on PVABs' *draft* advice *before* funds and other clients received it. ICI objected to this aspect of the proposal, and the SEC's final "review and notice" framework resembles ICI's "concurrent review" recommendation.[\[12\]](#) The change reflects SEC's recognition of "the timing pressures and logistical challenges faced by shareholders, investment advisers, registrants, and, as a result, proxy voting advice businesses and their clients, particularly during the peak of proxy season."[\[13\]](#) ICI's comment letter articulated these precise concerns.

Consistent with ICI's recommendation, the final amendments also exclude from the scope of these new requirements proxy voting advice based on custom policies that are proprietary to a PVAB's client.[\[14\]](#) Solicitations involving certain merger and acquisition transactions or contested matters (e.g., contested director elections) also are excluded from the scope of these requirements, due to their "fast-moving" nature and "short time windows."

Amended Proxy Antifraud Rule

The SEC amended the proxy antifraud rule (Rule 14a-9) to include examples of when a PVAB's failure to disclose certain information in proxy voting advice could be considered misleading.[\[15\]](#) Specifically, the amended rule lists failure to disclose material information such as the PVAB's methodology, sources of information, and conflicts of interest as examples of what may be misleading within the meaning of the rule.[\[16\]](#)

Compliance Dates

The amendments will be effective 60 days after publication in the *Federal Register*, but affected PVABs need not comply with the exemptive rule amendments (*i.e.*, the amendments to Rule 14a-2(b)(9)) until December 1, 2021. Thus, the SEC expects PVABs to be in full compliance with these requirements prior to the 2022 proxy season.

Supplemental Proxy Voting Guidance for Investment Advisers

The SEC last provided proxy voting guidance to investment advisers in August 2019.[\[17\]](#) This new guidance supplements the 2019 guidance, in light of the proxy advice rule amendments described above. The SEC believes that those amendments will result in registrants making additional information available to PVABs and investment advisers, and this guidance is meant to "assist investment advisers in assessing how to consider the additional information ..., including in circumstances where the investment adviser utilizes a proxy advisory firm's electronic vote management system... ." [\[18\]](#)

In the 2019 guidance, the SEC discussed a number of steps that an investment adviser could take to demonstrate that it is making proxy voting determinations in its clients' best interest. In this guidance, the SEC states that additional steps include assessing pre-populated votes and considering additional information that may become available prior to a voting deadline. The SEC states that "if an issuer files such additional information sufficiently in advance of the submission deadline and such information would reasonably

be expected to affect the investment adviser's voting determination, the investment adviser would likely need to consider such information prior to exercising voting authority in order to demonstrate that it is voting in its client's best interest."^[19]

The guidance also addresses disclosure obligations and client consent when investment advisers use automated voting services. It states that in determining the scope of an investment adviser's proxy voting responsibilities, and consistent with its duty of loyalty, an investment adviser must make full and fair disclosure to its clients of all material facts related to the exercise of voting authority. Accordingly, "an investment adviser that uses automated voting should consider disclosing: (1) the extent of that use and under what circumstances it uses automated voting; and (2) how its policies and procedures address the use of automated voting in cases where it becomes aware before the submission deadline ... that an issuer intends to file or has filed additional soliciting materials with the Commission regarding a matter to be voted upon."^[20] The SEC states that without this disclosure, a client may not have sufficiently specific information to provide informed consent "with respect to the use of automated voting as a means of exercising voting authority and for the adviser to satisfy its obligations under rule 206(4)-6 and Form ADV."^[21]

The guidance will be effective upon publication in the Federal Register.

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endnotes

^[1] *Exemptions from the Proxy Rules for Proxy Voting Advice*, SEC Release No. 34-89372 (July 22, 2020) ("Adopting Release"), available at www.sec.gov/rules/final/2020/34-89372.pdf.

^[2] *Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, Release No. IA-5547 (July 22, 2020) ("Investment Adviser Guidance"), available at www.sec.gov/rules/policy/2020/ia-5547.pdf.

^[3] The Commissioners supporting these items believe that they will enhance the accuracy, transparency, accountability, and effectiveness of the proxy system. See, e.g., *Proxy Voting—Reaffirming and Modernizing the Core Principles of Fiduciary Duty and Transparency to Provide for Better Alignment of Interest Between Main Street Investors and the Market Professionals Who Invest and Vote on Their Behalf*, Statement by SEC Chairman Clayton (July 22, 2020), available at www.sec.gov/news/public-statement/clayton-open-meeting-2020-07-22. By contrast, Commissioner Lee called the proxy advice amendments "unwarranted, unwanted, and unworkable." See *Paying More for Less: Higher Costs for Shareholders, Less Accountability for Management*, Statement by Commissioner Lee (July 22, 2020), available at www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22.

[4] The SEC uses this term to mean “the voting recommendations provided by proxy voting advice businesses on specific matters presented at a registrant’s shareholder meeting, or for which written consents or authorizations from shareholders are sought in lieu of a meeting, and the analysis and research underlying the voting recommendations that are delivered to the proxy voting advice business’s clients through any means, such as in a standalone written report or multiple reports, an integrated electronic voting platform established by the proxy voting advice businesses, or any combination thereof.” Adopting Release at n.7

[5] Adopting Release at 1.

[6] This amended definition of “solicitation” was adopted substantially as proposed. The definition further clarifies that furnishing proxy voting advice in response to an unprompted request would not be a solicitation subject to the proxy rules.

[7] Adopting Release at 94.

[8] This requires disclosure of: (i) any information regarding an interest, transaction, or relationship of the PVAB (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. These disclosure requirements are more streamlined than those of the proposal. Also, these final amendments do not dictate the particular location or presentation of this disclosure.

[9] The final amendments limit these review rights to registrants. The proposal also would have extended these review rights to “any other person conducting a solicitation... .”

[10] This requirement, which the SEC describes as “principles-based,” also has a related safe harbor. Specifically, a PVAB will be deemed to satisfy this requirement if it has written policies and procedures that are reasonably designed to provide a registrant with a copy of its proxy voting advice, at no charge, no later than the time such advice is disseminated to the PVAB’s clients. Such policies and procedures may include conditions requiring that the registrant: (i) file its definitive proxy statement at least 40 calendar days before the security holder meeting date; and (ii) acknowledge that it will only use the copy of the proxy voting advice for its internal purposes and/or in connection with the solicitation and such copy will not be published or otherwise shared except with the registrant’s employees or advisers. The SEC also clarifies that PVABs need not negotiate or otherwise engage in a dialogue with the registrant, or revise its voting advice in response to any feedback (Adopting Release at 103).

[11] This requirement also has a related safe harbor. Specifically, a PVAB will be deemed to satisfy this requirement if it has written policies and procedures that are reasonably designed to inform clients who receive proxy voting advice when a registrant that is the subject of such advice notifies the PVAB that it intends to file or has filed additional soliciting materials with the SEC addressing the advice, by providing notice to its clients: (i) on its electronic platform that the registrant intends to file or has filed such additional soliciting materials and including an active hyperlink to those materials on EDGAR when available; or (ii) through email or other electronic means that the registrant intends to file or has filed such additional soliciting materials and including an active hyperlink to those materials on EDGAR when available.

[12] See Letter from Paul Stevens, President and CEO, ICI, to Vanessa Countryman, Secretary, SEC, dated Feb. 3, 2020, *available at* www.sec.gov/comments/s7-22-19/s72219-6743669-207831.pdf.

[13] Adopting Release at 87.

[14] ICI's comment letter strongly recommended that any registrant review rights *not* include PVAB communications containing client-specific information.

[15] Rule 14a-9 prohibits any proxy solicitation from containing false or misleading statements with respect to any material fact at the time and in the light of the circumstances under which the statements are made.

[16] The proposal also included in this list use of standards that materially differ from relevant SEC standards or requirements. (An example would be a PVAB using a definition of "independence" in the election of a director on an audit committee that differs from that in the SEC's rules.) The final amendments do not include this item, due to its potential lack of clarity as to scope.

[17] *Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers*, SEC Release No. IA-5325 (Aug. 21, 2019), *available at* www.sec.gov/rules/interp/2019/ia-5325.pdf.

[18] Investment Adviser Guidance at 3. The SEC explains that such an electronic platform may provide for: (i) "pre-population" of the investment adviser's proxies with suggested voting recommendations based on the investment adviser's instructions, and/or (ii) automatic submission of the investment adviser's votes. These actions generally occur following the release of the PVAB's recommendation and before the deadline for submitting votes for a shareholder meeting.

[19] *Id.* at 5.

[20] *Id.* at 6-7.

[21] *Id.* at 7.