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SEC Proposes Amendments to Proxy Rules Affecting Proxy Advisory Firms and Shareholder Proposals

[32048]

November 11, 2019 TO: ICI Members
Investment Company Directors SUBJECTS: Compliance
Disclosure
Fund Governance
Intermediary Oversight
Investment Advisers
Operations
Transfer Agency RE: SEC Proposes Amendments to Proxy Rules Affecting Proxy Advisory Firms and Shareholder Proposals

Last week, the SEC proposed amendments to its proxy rules that would:

- more substantively regulate proxy advisory firms' activities;[1] and
- modify the requirements for including shareholder proposals on companies' proxies.[2]

Each proposal passed by a 3-2 vote, with Chairman Clayton and Commissioners Roisman and Peirce voting for each, and Commissioners Jackson and Lee voting against each.[3]

Comments are due on each proposal 60 days after publication in the Federal Register.

Proposed Amendments Affecting Proxy Voting Advice Businesses

Proxy advisory firms (or "proxy voting advice businesses" as they are referred to in the proposing release, and which we abbreviate herein as "PVABs") provide proxy voting advice[4] to institutional investors, including investment advisers and funds. This proposal's intent is to "help ensure that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions, in a manner that does not impose undue costs or delays… ."[5]

This proposal would:

- Codify the SEC's interpretation that proxy voting advice generally constitutes a "solicitation" within the meaning of the Securities Exchange Act of 1934 ("Exchange

Act");
- 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 discuss each below.

Proposed Amendments to the "Solicitation" Definition

In the proposing release, the SEC reiterates its view that proxy voting advice provided by PVABs generally constitutes a "solicitation" subject to the proxy rules.[6] Proposed amendments to Rule 14a-1(l) would codify this interpretation to make clear that the terms "solicit" and "solicitation" include 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 who markets its expertise as a provider of such advice, separately from other forms of investment advice, and sells such advice for a fee.[7]

Proposed 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 proposal would impose several new conditions on PVABs' use of these exemptions. The SEC believes these new conditions would "(i) improve proxy voting advice businesses' disclosures of conflicts of interests that would reasonably be expected to materially affect their voting advice, (ii) establish effective measures to reduce the likelihood of factual errors or methodological weaknesses in proxy voting advice, and (iii) ensure that those who receive proxy voting advice have an efficient and timely way to obtain and consider any response a registrant or certain other soliciting person may have to such advice."[8]

Specifically, the proposal would require that:

- PVABs include disclosure of material conflicts of interest in[9] their proxy voting advice.[10]
- PVABs provide companies (and certain other soliciting persons) with an opportunity to review and provide feedback on proxy advice before it is issued, with the length of review generally as follows:
  - no less than five business days before issuance, if the company (or other soliciting person) has filed its definitive proxy statement at least 45 calendar days before the meeting date; and
  - no less than three business days before issuance, if the company (or other soliciting person) has filed its definitive proxy statement less than 45 calendar days, but at least 25 calendar days, before the meeting date.
- PVABs additionally provide companies (and certain other soliciting persons) a final notice of voting advice (no earlier than the applicable review period and no later than two business days prior to delivery to clients). This final notice must include a copy of the proxy voting advice that will be delivered to clients, including any revisions made

after the review and feedback period.[11]
- PVABs include in the final proxy voting advice a hyperlink that leads to a statement with the company's (or soliciting person's) views on the advice, upon request.[12]

If a company (or other soliciting person) files its definitive proxy statement less than 25 calendar days before the meeting, the PVAB need not provide the proxy voting advice to that party. Also, the proposed review provisions would not require the PVAB to accept any suggested revisions.

The proposed amendments also would:

- Permit a PVAB to require the registrant (or other soliciting person) to enter into an agreement to maintain the confidentiality of any materials it receives; and
- stipulate that an immaterial or unintentional failure of a PVAB to comply with one or more of the new conditions would not result in the PVAB's loss of the exemptions, subject to certain conditions.

Proposed Amendments to the Proxy Antifraud Rule

The proposal would amend the proxy antifraud rule (Rule 14a-9) to include examples of when the failure to disclose certain information in the proxy voting advice could be considered misleading.[13] Specifically, the amended rule would list failure to disclose information such as the PVAB's methodology, sources of information, conflicts of interest, and use of standards that materially differ from relevant SEC standards or requirements[14] as examples of what may be misleading within the meaning of the rule.

Proposed Amendments to Rule 14a-8 (Shareholder Proposals)

Rule 14a-8 under the Exchange Act conditionally permits a company's shareholders to include proposals (i.e., recommendations or requirements that a company and/or its board take action) on a company's proxy statement.

The proposed amendments to Rule 14a-8 would:

- Replace the current ownership requirements with a tiered approach providing three options for demonstrating an ownership stake through a combination of amount of securities owned and length of time held;
- Require certain documentation to be provided when a proposal is submitted on behalf of a shareholder-proponent;
- Require shareholder-proponents to state when they would be able to meet with the company in person or via teleconference to engage with the company with respect to the proposal;
- Provide that a person may submit no more than one proposal, directly or indirectly, for the same shareholders' meeting; and
- Raise the current resubmission thresholds for shareholder proposals.

We discuss each below.

Proposed Amendments to the Eligibility Requirements

Currently, to submit a proxy proposal, a shareholder must continuously hold at least $2,000 in market value (or one percent) of a company's stock and be entitled to vote for at least one year. In the proposing release, the SEC notes that it has not revised these ownership requirements since 1998 and suggests that "holding $2,000 worth of stock for a single year

does not demonstrate enough of a meaningful economic stake or investment interest in a company to warrant the inclusion of a shareholder's proposal in the company's proxy statement."[15]

The proposed amendments would update the ownership requirements by:

- Eliminating the one percent threshold; and
- Providing three alternative thresholds to establish eligibility to submit a proposal:
    - continuous ownership of at least $2,000 of the company's securities for at least three years;
    - continuous ownership of at least $15,000 for at least two years; or
    - continuous ownership of at least $25,000 for at least one year.[16]

In addition to these proposed changes to ownership requirements, other proposed eligibility-related amendments would:

- Require that a shareholder-proponent using a representative to provide documentation attesting that the shareholder supports the proposal and authorizes the representative to submit it on the shareholder's behalf.[17]
- Require a statement from each shareholder-proponent that he or she is able to meet with the company in person or via teleconference no less than 10 calendar days, nor more than 30 calendar days, after submission of the shareholder proposal.[18]
- Apply the current one-proposal limit to "each person" rather than "each shareholder" who submits a proposal.[19]

Proposed Amendments to the "Resubmissions" Exclusion

Rule 14a-8(i) provides bases upon which a company may exclude a shareholder proposal, including a "resubmissions" exclusion. Currently, for a shareholder to be eligible to resubmit the same (or a similar) proposal, the proposal must have received at least 3, 6, and 10 percent shareholder approval for the first, second, and third submissions, respectively, each within the preceding 5 calendar years.

The proposal would raise the current resubmission thresholds to 5, 15, and 25 percent, respectively.[20] Also, the SEC has proposed a new "momentum requirement," whereby a company could exclude a proposal that had been previously voted on three or more times in the last five years, notwithstanding having received at least 25 percent of the votes cast on its most recent submission, if at the time of the most recent vote the proposal:

- Received less than 50 percent of the votes cast; and
- Experienced a decline in shareholder support of 10 percent or more compared to the immediately preceding vote.[21]

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endnotes

[1] Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, SEC Release No. 34-87457 (Nov. 5, 2019) (“Proxy Advice Proposal”), available at https://www.sec.gov/rules/proposed/2019/34-87457.pdf.

[2] Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, SEC Release No. 34-87458 (Nov. 5, 2019)(“Rule 14a-8 Proposal”), available at www.sec.gov/rules/proposed/2019/34-87458.pdf.

[3] The Commissioners voting for the Proxy Advice Proposal emphasized the need for proxy advisory firms to provide material information (including that related to potential conflicts of interest and underlying methodologies) to their customers and engage with the companies on which they issue proxy advice. The Commissioners opposing this proposal stressed that it could shield management from accountability and questioned whether increased engagement as proposed would improve the quality of the firms’ advice.

The Commissioners voting for the Rule 14a-8 Proposal emphasized the need to consider the rights of all shareholders—not just proposal proponents—and the costs that the current requirements impose on all. By contrast, the Commissioners opposing this proposal expressed concerns that shareholder rights would be negatively affected, and that the proposal did not sufficiently consider its potential effects.

The Commissioners’ statements may be accessed at www.sec.gov/news/statements.

[4] The SEC generally uses this term to mean the voting recommendations provided by PVABs on specific matters presented at a company’s shareholder meeting, along with the analysis and research underlying the voting recommendations.

[5] Proxy Advice Proposal at 1.

[6] See, e.g., Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, SEC Release No. 34-86721 (Aug. 21, 2019).

[7] However, the SEC states that in circumstances in which a person, such as a broker-dealer or an investment adviser, receives an unprompted client request for voting advice, any advice given in response should not be regarded as a solicitation subject to the proxy rules.

[8] Proxy Advice Proposal at 27.

[9] Currently, Rule 14a-2(b)(3)(ii) requires that disclosure of conflicts-related information be conveyed to the recipient of the proxy voting advice, but does not specify in what manner.

[10] This would require disclosure of: (i) any material interests, direct or indirect, of the PVAB in the matter or parties concerning which it is providing the advice; (ii) any material transaction or relationship between the PVAB and the company, another soliciting person, or a shareholder proponent, in connection with the matter covered by the proxy voting advice; (iii) any other information regarding the interest, transaction, or relationship of the PVAB that is material to assessing the objectivity of the proxy voting advice; and (iv) any policies and procedures used to identify, as well as the steps taken to address, any such material conflicts of interest arising from such interest, transaction, or relationship.

[11] This second review is meant to provide registrants the opportunity to determine (i) the extent to which the proxy voting advice has changed, and (ii) whether to provide a statement in response to the advice and request that a hyperlink to its response be included in the voting advice delivered to clients.

[12] The company (or other soliciting person) would have to file such statement as additional solicitation material.

[13] 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.

[14] 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.

[15] Rule 14a-8 Proposal at 19.

[16] In a change from what is currently permitted, the Commission proposes to prohibit shareholders from aggregating their securities with those of other shareholders to meet the applicable thresholds. Abstentions and broker non-votes would not be included in the calculation.

[17] The SEC’s policy objective is to “help to make clear that the representative has been so authorized… “ and “help to ensure that the interest being advanced by the proposal is the shareholder’s own.” Rule 14a-8 Proposal at 31.

[18] This would introduce a shareholder engagement component, which the SEC encourages “both before and after the submission of a shareholder proposal.” Rule 14a-8 Proposal at 33.

[19] The SEC’s concern is that permitting representatives to submit multiple proposals for the same shareholders’ meeting would undermine the purpose of the one-proposal limit.

[20] The SEC’s concern is “that the current resubmission thresholds may allow proposals that have not received widespread support from a company’s shareholders to be resubmitted—in some cases, year after year—with little or no indication that support for the proposal will meaningfully increase or that the proposal ultimately will obtain majority support.” Rule 14a-8 Proposal at 48.

[21] The SEC’s rationale is that “a 10 percent decline in the percentage of votes cast may demonstrate a sufficiently significant decline in shareholder interest to warrant a cooling-off period.” Rule 14a-8 Proposal at 59. For example, a proposal would be excludable where it deals with substantially the same subject matter as had previously been voted on three times in the preceding five years, and received 26% of votes cast on the third submission, compared to 30% on the second submission. (In this case, a 10% decline would be 3% (30 x 10%), and the actual 4% decline exceeds this threshold.)