

SANGRA MOLLER LLP*Barristers & Solicitors***LEGAL CURRENCY***A Client Communication****U.S. Securities and Exchange Commission Adopts Rules Regarding Proxy Advisory Firms***

On July 22, 2020, the U.S. Securities and Exchange Commission (the "SEC") voted to adopt final rules regarding proxy solicitation respecting those providing proxy voting advice.

The final rules are effective 60 days following publication in the federal register. Proxy advisory firms subject to the amended rules must begin compliance with such rules by December 1, 2021.

I. Background

Generally, proxy advisory firms are businesses that compile and analyze information about public companies and issue voting recommendations on various matters of topics tabled at shareholder meetings. The customers for such services are generally institutional investors. Accordingly, as the advisory firms exercise a large amount of influence over institutional investors who themselves exercise a large amount of influence over public companies, many critics believe the proxy advisory industry should be subject to higher levels of regulation and scrutiny.

The SEC has noted a number of concerns over this industry, including that proxy advisors: (1) may have conflicts of interest that are insufficiently disclosed or managed; (2) may not be adequately held accountable for informational accuracy; and (3) may significantly influence shareholder voting without appropriate oversight, and without having an actual economic stake in the issuer. Whether such concerns are warranted has been heavily debated over the past decade, predictably with proxy advisory firms on one side and public companies on the other.

In adopting final rules, the SEC's goal is to help investors who use proxy voting advice to "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".

II. Final Rule Amendments**Definition of "Solicitation"**

Pursuant to Section 14(a) of the U.S. Securities Exchange Act of 1934 (the "**Exchange Act**") it is unlawful for any person to "solicit" any proxy with respect to any registered security in contravention of prescribed rules and regulations. The Exchange Act itself does not define "solicitation".

The new rules specify that the terms "solicit" and "solicitation" include any proxy voting advice that makes a recommendation to a security holder as to its vote, consent, or authorization on a specific matter for which security holder approval is solicited, and that is furnished by a person that markets its expertise as a provider of such proxy voting advice, separately from other forms of investment advice, and sells such proxy voting advice for a fee.

In addition, the new rules add that the terms "solicit" and "solicitation" exclude any proxy voting advice furnished by a person who furnishes such advice only in response to an unprompted request.

These amendments clarify that proxy voting advice generally constitutes a solicitation pursuant to Section 14(a) of the Exchange Act. Where proxy voting advice is deemed a solicitation, firms offering such services may now be subject to the same information and filing requirements as the registrants that are the subject of the advice given to their respective clients.

Conflicts of Interest; Notice of Proxy Voting Advice and Registrant's Response

The SEC amended its rule to require that persons who provide proxy voting advice in reliance on exemptions from certain information and filing requirements of the proxy rules must include conflicts of interest disclosure. Under the amendments, in order for proxy voting advice businesses to rely on these exemptions, they must satisfy principles-based

conditions, which generally require that they must:

- prominently disclose specified material conflicts of interest information in their proxy voting advice or in an electronic medium used to deliver the proxy voting advice; and
- have adopted and must publicly disclose written policies and procedures reasonably designed to ensure that:
 - (i) registrants 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 proxy voting advice business's clients; and
 - (ii) the proxy voting advisor provides its clients with a mechanism by which they can reasonably be expected to become aware of any written statements regarding its proxy voting advice by registrants who are the subject of such advice, in a timely manner before the security holder meeting.

The final rules provide safe harbors for proxy advisors so that their respective written policies and procedures satisfy the above:

- A proxy advisor will be deemed to satisfy the first prescribed requirement above if its written policies and procedures are reasonably designed to provide registrants with a copy of its proxy voting advice, at no charge, no later than the time it is disseminated to the business's clients. The safe harbor also specifies that such policies and procedures may include conditions requiring registrants to (i) file their definitive proxy statement at least 40 calendar days before the security holder meeting and (ii) expressly acknowledge that they will only use the proxy voting advice for their internal purposes and/or in connection with the solicitation and will not publish or otherwise share the proxy voting advice except with the registrant's employees or advisers.
- A proxy voting advice business will be deemed to satisfy the second prescribed requirement above if its written policies and procedures are reasonably

designed to provide notice on its electronic client platform or through email or other electronic means that the registrant has filed, or has informed the proxy voting advice business that it intends to file, additional soliciting materials setting forth the registrant's statement regarding the advice (and include an active hyperlink to those materials on EDGAR when available).

The new requirement for conflicts of interest disclosure is a long-anticipated change. The nature of proxy advisory firms give rise to many potential circumstances in which such a conflict may exist. While having a primary business of providing voting advice to shareholders, they may often also receive fees from registrants for providing advice on corporate governance and compensation policies. As another example, the firm may provide advice concerning either a registrant in which one of its clients has a material interest or concerning a shareholder proposal put forward or supported by such clients.

In addition, through the new timing requirements related to disseminating proxy advice and responses, the SEC aims to improve transparency of information and increase dialogue between advisory firms and registrants. While the advisory firms argue that the system is not broken, the opposing view can be seen in considering the two dominant names in proxy advisory services: Institutional Shareholder Services (ISS) and Glass Lewis. With respect to its analysis, ISS currently only provides a review opportunity to U.S. issuers if they are in the S&P 500, and to Canadian companies if they are in the S&P/TSX Composite index. Glass Lewis will provide issuers with its data points 48 hours prior to publication of its proxy papers, but charges for proxy advice. The new rules provide incentives for proxy advisors to provide this information to the registrants that are the subject of proxy voting advice at the time the same is distributed to business clients and afford a mechanism through which the clients can be made aware of any of the registrant's written responses.

Prohibition on False and Misleading Statements

Rule 14a-9 prohibits any proxy solicitation from containing false or misleading statements with respect to any material fact at the time and in light of the circumstances under which the statements are made and similarly must not omit to state any material fact necessary in order to make the statements therein not false or misleading.

The final amendments to such rule includes examples and add a provision that provides that the failure to disclose material information regarding proxy voting advice, "such as the proxy voting advice business's methodology, sources of information, or conflicts of interest" could, depending

upon particular facts and circumstances, be misleading within the meaning of the rule.

This communication is intended to provide general information as a service to our clients and should not be construed as legal advice or opinions on specific facts.