

# SEC issues guidance regarding activities of proxy advisory firms

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Last week, the U.S. Securities and Exchange Commission (SEC) issued:

- its interpretation that voting advice communications from proxy advisory firms are generally solicitations that are subject to SEC antifraud rules prohibiting proxy solicitations from containing materially false or misleading statements; and
- guidance on the responsibilities of investment advisers which use services of proxy advisory firms.

Unless an exemption is available, the SEC's proxy rules apply to any solicitation for a proxy for any security that is registered under Section 12 of the U.S. Securities Exchange Act of 1934 (such as securities listed on U.S. stock exchanges) and require compliance with a number of procedural and substantive requirements, such as the need to file a proxy statement with the SEC and adhere to antifraud provisions.

The SEC noted that the definition of the term "solicitation" in its proxy rules is broad and includes a communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy. The SEC stated that proxy rules can cover a person even in cases where the person is not seeking the procurement, withholding or revocation of a proxy for itself or is indifferent to the ultimate outcome. In assessing the applicability of the definition of solicitation to communications from proxy advisory firms, the SEC stated that whether a particular communication is a solicitation often turns on whether the purpose is to influence shareholders' decisions. The SEC observed that proxy advisory firms market their expertise in researching and analyzing matters submitted to a shareholder vote for the purpose of assisting their clients in making voting decisions at shareholder meetings and that many investment advisers retain and pay a fee to proxy advisory firms to provide detailed analyses, including how to vote on shareholder proposals. As a result, the SEC expressed the view that voting advice provided by proxy advisory firms for the purposes of helping clients make proxy voting decisions (as compared to performing merely administrative or ministerial services) should be considered as solicitations subject to the SEC's proxy rules, even if the clients may not follow the advice.

Proxy advisory firms can avail themselves of exemptions from many of the information and filing requirements under the SEC's proxy rules, and in its interpretation, the SEC indicated that it was not intending to restrict the availability of those exemptions. However, advice from proxy advisory firms that are solicitations would be subject to the Rule 14a-9 antifraud provision in the SEC's proxy rules, which prohibits solicitations from containing false or misleading statements with respect to material facts or omitting material facts. The SEC stated that Rule 14a-9 can extend to opinions, reasons, recommendations or beliefs disclosed as part of a solicitation, and that in those cases disclosure of underlying facts, assumptions, limitations and other information may be needed to address Rule 14a-9 concerns. For example, the SEC indicated that proxy advisory firms should consider disclosing the following in order to avoid a potential violation of Rule 14a-9:

- an explanation of the methodology used to formulate their voting advice on particular matters (including any material deviations from their publicly announced guidelines, policies or standard methodologies for analyzing such matters) where the omission of the information would otherwise render the voting advice materially false or misleading;
- to the extent that the voting advice is based on information other than the subject public company's public disclosures, such as third-party information sources, disclosure about those information sources and the extent to which the information from these sources differs from the company's public disclosures if the differences are material and the failure to disclose them would render the voting advice false or misleading; and
- disclosure about material conflicts of interest that arise in connection with providing the proxy voting advice in reasonably sufficient detail so that the client can assess the relevance of those conflicts.

The SEC also issued guidance regarding the responsibilities of investment advisers that retain the services of a proxy advisory firm to provide research or voting recommendations. The SEC stated that investment advisers, prior to retaining a proxy advisory firm and periodically thereafter, should consider, among other things:

- whether the proxy advisory firm has the capacity and competency to adequately analyze the matters for which the investment adviser is responsible for voting, including the adequacy and quality of the proxy advisory firm's staffing, personnel, and/or technology;
- whether the proxy advisory firm has an effective process for seeking timely input from issuers and proxy advisory firm clients with respect to its proxy voting policies, methodologies, and peer group constructions; and
- the proxy advisory firm's policies and procedures respecting conflicts of interest.

The SEC also confirmed that an investment adviser that has voting authority may refrain from voting a proxy on behalf of a client if it has determined that refraining is in the best interest of that client, including where the investment adviser determines that the cost to the client of voting the proxy exceeds the expected benefit to the client.

## Canadian implications

The SEC's proxy rules do not apply to securities of most Canadian companies that are registered under the Securities Exchange Act of 1934, such as companies with cross-listings on the New York Stock Exchange or Nasdaq Stock Market, because of an exemption available for foreign private issuers. However, the SEC's interpretation and guidance will apply to securities of Canadian companies that are registered under Section 12 and that must comply with the SEC's proxy rules and investment advisers registered under the Investment Advisers Act of 1940 and may influence practices by proxy advisory firms and their investment adviser clients in Canada.