BNY MELLON

Debevoise & Plimpton

STAY CURRENT:

SEC Proposes to Subject Proxy Voting Advice to U.S. Federal Proxy Rules

Depositary Receipts

On November 5, 2019, the U.S. Securities and Exchange Commission (the "SEC") proposed amendments (the "Proposed Rules") to the federal proxy rules under the Securities Exchange Act of 1934 (the "Exchange Act"). The Proposed Rules, which passed by a 3-2 vote of the SEC's Commissioners, would impose additional disclosure and procedural requirements on proxy advisory firms under the federal proxy rules.
The Proposed Rules track and go beyond the key aspects of the SEC's August 21, 2019 interpretation and guidance (the "Interpretive Release") in which the SEC stated that proxy voting advice provided by proxy advisory firms constitutes a "solicitation" under the Exchange Act and, as a result, is subject to the federal proxy rules.

Why is the SEC proposing regulations on proxy advisors, and what are the Proposed Rules?

The SEC indicated that it proposed the rule amendments “to enhance the accuracy, transparency of process, and material completeness of the information provided to clients of proxy voting advice businesses when they cast their votes ... [and] to enhance disclosures of conflicts of interest that may materially affect the proxy voting advice businesses’ voting advice.”

If adopted, the Proposed Rules would: (i) codify the SEC’s Interpretive Release position that proxy voting advice generally constitutes a “solicitation” under the Exchange Act (and, as a result, is subject to regulation under the federal proxy rules, including the general anti-fraud prohibition therein) and (ii) impose additional disclosure and procedural requirements on proxy advisory firms. As a result, proxy advisory firms would be required to make certain filings with the SEC under the federal proxy rules absent an applicable exemption. The Proposed Rules would condition proxy advisory firms’ ability to rely on an exemption from filing on the following:

- The inclusion of conflicts of interest disclosures alongside their final proxy voting advice.
- Companies and certain other soliciting persons covered by the proxy voting advice being provided a specified amount of time to review and provide comments on the proxy voting advice before it is disseminated to their clients.[1]
- The provision of a final notice of the proxy voting advice to the company and other soliciting persons at least two days prior to delivering the advice to their clients.
- If companies or other soliciting persons submit comments to a proxy advisory firm on the final notice of voting advice within the two-day period referenced above, they may require the firm to include a hyperlink to these comments in the proxy voting advice disseminated to clients.[2]

Notwithstanding the availability of an exemption from filing, proxy voting advice would remain subject to the prohibition on false and misleading statements in the federal proxy rules and the Proposed Rules would amend the federal proxy rules to highlight the types of information that a proxy advisor may, depending upon the facts and circumstances, need to disclose to avoid violating such anti-fraud prohibition.

[1] The mandated review periods are: (a) at least five business days for proxy statements filed 45 calendar days or more before the shareholder meeting, (b) at least three business days for proxy statements filed 25-45 calendar days before the shareholder meeting and (c) no required review period for proxy statements filed less than 25 calendar days before the shareholder meeting. Proxy advisory firms are not required to modify their advice based on comments received.

[2] If a company or soliciting person chooses to have comments included, these comments would be considered a solicitation and would be subject to SEC rules and regulations regarding solicitations of proxies.

Institutional investors and proxy advisory firms have, in general, come out against the Proposed Rules. What are their primary objections?

The primary types of objections to the SEC's Proposed Rules may be generally summarized as follows:

- There is little evidence to support claims that proxy advisory firms publish reports with "errors" or engage in "pervasive inaccuracies", and proxy advisory firms already have policies and procedures in place to correct inaccurate or misleading information.
- Requiring more engagement between proxy advisory firms and companies both increases proxy advisory firms' costs and intrudes on the principal/agency relationship between institutional investors and proxy advisory firms which impairs the independence of the proxy advisory firms and, in turn, will harm institutional and retail investors.
- The proposed mandated comment periods and final notice period regarding proxy advisory reports will increase costs and cause timing inefficiencies that could pose challenges for the orderly management of the proxy season process by all relevant participants, including companies, investors and proxy advisory firms.
- The SEC's position that proxy voting advice generally constitutes a "solicitation" under the Exchange Act is not supported by the text of Section 14A of the Exchange Act, the federal proxy rules or the SEC's historical position and guidance on point.
- Explicitly subjecting proxy advisory firms to potential anti-fraud liability under the federal proxy rules would expose such firms to potentially material litigation exposure.

Note that the Interpretive Release stands as the SEC's current position regarding the regulation of proxy advisory firms under the federal proxy rules in the absence of formally adopted final rules. Following the issuance of the Interpretive Release (but prior to the issuance of the Proposed Rules), Institutional Shareholder Services Inc. ("ISS") sued the SEC challenging the applicability of the federal proxy rules to proxy advisory firms. ISS's primary substantive argument is that proxy voting advice (an activity already regulated in the U.S. under the Investment Advisers Act of 1940) and proxy solicitation (an activity regulated under the Exchange Act), are two fundamentally different activities.

If approved, will non-U.S. companies be impacted by the Proposed Rules?

Generally speaking, a non-U.S. company that is active in the U.S. capital markets will not be impacted by the Proposed Rules if it is a "Foreign Private Issuer" ("FPI"). Most non-U.S. companies that are SEC registrants are FPIs.[3] Non-U.S. companies with securities registered in the U.S. that do not qualify as FPIs are subject to the federal proxy rules and would be impacted by the Proposed Rules much like U.S. companies will be impacted.

While the adoption of Proposed Rules would not as a matter of law impact FPIs, it is possible that their adoption could spur regulators in other jurisdictions to adopt similar regulations which would ultimately apply to FPIs via their home country regulations.

When will the Proposed Rules become law?

While there are a number of factors that may impact if and when the Proposed Rules become law, it is possible that final rules could be adopted as early as April or May 2020. If adopted as proposed, there would be a one-year transition period before proxy advisory firms would be required to comply with the new regulations, though the SEC could choose to delay the compliance date so that the new regulations do not take effect in the middle of the proxy season (generally from February to June each year).

The Proposed Rules are subject to a 60-day comment period which ends on February 3, 2020, unless extended. Because the SEC reviews all submitted comments (and even those submitted after the comment period ends) and will need to revise and complete its economic analysis of the impact of Proposed Rules, how quickly the SEC adopts final rules after the comment period ends will, to a large extent, depend on the extent and the nature of the comments received. Given that regulation of proxy advisory firms has been under SEC consideration for many years, it is reasonable to believe that the SEC will act quickly to adopt the final rules once the comment period passes.

[3] A non-U.S. company qualifies as an FPI unless U.S. residents directly or indirectly hold 50% or more of the company's outstanding voting securities and (i) the majority of the company's executive officers or directors are U.S. citizens or residents; (ii) more than 50% of the company's assets are located in the U.S.; or (iii) the company's business is principally administered in the U.S.

As an issuer, is there anything that I should be doing to influence the direction that the SEC takes in the future?

The SEC seeks input from interested parties on all proposed rules. As noted above, the Comment Period will end on February 3, 2020, unless extended. Those wishing to submit comments on the Proposed Rules to the SEC can do so **here**.

In addition to the SEC Proposed Rules, are there any regulations afoot outside of the U.S. that would materially impact the way in which proxy advisors engage with issuers?

Proxy advisory firms in non-U.S. jurisdictions may be subject to: (i) particular regulations (as is the case with the European Union, including currently the United Kingdom and France) or (ii) stewardship codes, licensing requirements and other forms of binding and non-binding regulatory guidance (as is the case with Australia, Canada, Hong Kong and Japan) that require proxy advisory firms to, among other things, adhere to codes of conduct or provide certain conflicts of interest disclosure. However, as of the date hereof, the U.S. is the only country that has proposed proscriptive regulations mandating issuer review periods and requiring specific potential conflicts of interest disclosure.

BNY Mellon Depositary Receipts published, in partnership with Debevoise and Plimpton, this Q&A paper which outlines key details and provide insights around possible scenarios should the proposed rules be adopted. The paper also provides intelligence into the applicability for foreign issuers. At present, the proposed rules are standing for comment in compliance with the SEC's 60-day comment period, which is scheduled to end on February 3, 2020. For more information, please contact:

Guy Gresham
Group Head, Global IR Advisory & Investor Solutions
+1 212 815 4693
guy.gresham@bnymellon.com

Karen Bodner
Head, Global IR Advisory
+1 212 815 2557
karen.bodner@bnymellon.com

Michael O'Brien
Senior Corporate Governance Specialist
+1 212 815 6007
michael.o'brien@bnymellon.com

Matthew E. Kaplan
Partner
+1 212 909 7334
mekaplan@debevoise.com

"Debevoise & Plimpton LLP is a premier law firm with market-leading practices, a global perspective and strong New York roots. We deliver effective solutions to our clients' most important legal challenges, applying clear commercial judgment and a distinctively collaborative approach."

Debevoise & Plimpton

BNY MELLON

bnymellon.com

BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment
BNY Mellon is a global investments company dedicated to helping its clients manage and service their financial assets throughout the investment
lifecycle. Whether providing financial services for institutions, corporations or individual investors, BNY Mellon delivers informed investment management and investment services in 35 countries. As of Dec. 31, 2019, BNY Mellon had $37.1 trillion in assets under custody and/or administration, and $1.9 trillion in assets under management. BNY Mellon can act as a single point of contact for clients looking to create, trade, hold, manage, service, distribute or restructure investments. BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation (NYSE: BK). Additional information is available on www.bnymellon.com. Follow us on Twitter @BNYMellon or visit our newsroom at www.bnymellon.com/newsroom for the latest company news.

158_DR_Insights_Proxy Advisory Paper_1_20