

SEC to Revisit Regulation of Proxy Advisory Firms

On June 1, 2021, the new Chair of the Securities and Exchange Commission, Gary Gensler, directed the Staff to consider whether to revisit the SEC's 2019 interpretive guidance and 2020 rule amendments that would subject proxy advisory firms, primarily Institutional Shareholder Services ("ISS") and Glass Lewis (which control 95% of the market), to the proxy solicitation rules of the Securities Exchange Act of 1934. Subsequently, the Division of Corporation Finance indicated that it would recommend that the SEC revisit the 2019 interpretive guidance and the 2020 rule amendments and would not recommend enforcement action based on either the guidance or the rule amendments while the SEC decides whether to take any further regulatory action. *Consequently, the proposed December 1, 2021 compliance date requiring the proxy advisory firms to make their proxy voting advice available to companies at the same time as it is sent to their clients and to notify their clients when a company has issued a written response to their proxy voting advice is unlikely to take effect.*

Background

The regulation of ISS, Glass Lewis, and the other proxy advisory firms by the SEC has been a major controversy between the corporate and investor communities for several years. In 2019, following a well-publicized roundtable forum to discuss the proxy process and rules, including the role of proxy advisory firms, the SEC issued an interpretation and guidance confirming the application of the proxy rules to proxy advisory firms and the reports containing proxy voting advice they publish for their clients (the "September 2019 Guidance"). Essentially, the September 2019 Guidance confirmed what the SEC characterized as its long-standing position that the proxy voting advice issued by proxy advisory firms constituted a "solicitation" under the proxy rules, subjecting the firms to the antifraud provisions of the proxy rules and prescribing certain specific disclosure requirements.

Subsequently, in July 2020, the SEC, by a vote of 3-1, formally amended the proxy rules to codify its position that proxy voting advice is a "solicitation" subject to the proxy rules and to require

proxy advisory firms to disclose any conflicts of interest, be fully transparent in their evaluation methodologies, and adopt policies that would enable companies to review and respond to the voting recommendations on matters to be submitted for shareholder action at their annual meetings (the "2020 Rule Amendments"). To allow adequate time for the proxy advisory firms to prepare for their new obligations to avoid being considered proxy solicitors, application of the policy requirements was deferred until December 1, 2021.

If anything, the 2020 Rule Amendments have dramatically refueled the ongoing debate over how the federal securities laws apply to proxy advisory firms, which culminated in a lawsuit filed by ISS last fall challenging the SEC's authority to regulate such firms under the Exchange Act. On the other hand, the corporate community has generally been supportive of the 2020 Rule Amendments and the SEC's apparent willingness to curb the growing influence of the proxy advisory firms.

The Chair's Directive

By directing the SEC Staff to consider whether to revisit the question of whether proxy advisory firms are proxy solicitors, the SEC Chair has opened the door to the possibility that the September 2019 Guidance and the 2020 Rule Amendments will be changed, if not reversed. Notwithstanding the strong support for the September 2019 Guidance and the 2020 Rule Amendments, it appears that the SEC, which now consists of a majority of Democratic members, is poised to take action once it has received the Staff's recommendations. The debate is certain to be heated. The two remaining Commissioners who voted in favor of the 2020 Rule Amendments noted their objections to the Chair's directive, defended the integrity of the rulemaking process and pointed out that, given the compliance date is still months away, there is as of yet no data upon which to evaluate how the rules will work in practice.

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Corporation Finance's Announcement

In addition to announcing that it would consider recommending to the SEC whether to revisit the September 2019 Guidance and the 2020 Rule Amendments, the Division of Corporation Finance indicated that:

- It will not be enforcing the September 2019 Guidance or the 2020 Rule Amendments for the time being; and
- If any new SEC action leaves the exemptions to the 2020 Rule Amendments slated to go into effect December 1, 2021 in place, the Staff will not enforce those conditions for a reasonable period of time after the resumption of the ISS lawsuit challenging the 2020 Rule Amendments and the September 2019 Guidance.

What's Next?

Given the prominence of this issue, it is highly likely that the Staff will be presenting its recommendations to the SEC in the near future. This could very well lead to be 2020 Rule Amendments being overturned. As it appears that a majority of the Commission does not support the current position that proxy advisory firms are proxy solicitors, the Staff's decision to suspend enforcement of the September 2019 Guidance and the 2020 Rule Amendments may eventually lead to their revision or repeal.

Further Information

Here's [Chair Gensler's directive](#) and the Division of Corporation Finance's [announcement](#). ■

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About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management.

Silicon Valley

50 W San Fernando Street
Suite 1350
San Jose, California 95113
408.876.4025

Thomas G. Brown, Chairman
tbrown@compensia.com
408.876.4023

Aaron Johansen
ajohansen@compensia.com
408.907.4310

Tom LaWer
tlawer@compensia.com
408.907.4309

Greg Lochmann
glochmann@compensia.com
408.907.4319

San Francisco

One Embarcadero Center
Suite 2830
San Francisco, California 94111
415.462.2990

Mark A. Borges
mborges@compensia.com
415.462.2995

Erik Beucler
ebeucler@compensia.com
408.907.4314

Amanda Feyerabend
afeyerabend@compensia.com
415.462.2988

Southern California

Ralph Barry
rbarry@compensia.com
858.603.2288

Pacific Northwest

Jason Borrevik
jborrevik@compensia.com
408.876.4035