

SEC Issues Staff Legal Bulletin No. 20: Clarifying Disclosure Requirements For Proxy Advisory Firms

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Background

On June 30, 2014, the SEC's Divisions of Investment Management and Corporation Finance released Staff Legal Bulletin No. 20, a set of thirteen Questions and Answers offering guidance on:

- the duties of investment advisors in voting client proxies and retaining proxy advisory firms (Questions 1-5), and
- the availability and requirements of two exemptions from the federal proxy rules often relied upon by proxy advisor firms (Questions 6-13).

This Alert focuses on the second area of guidance, relating to exempting proxy advisory firms, such as Institutional Shareholder Services (ISS) and Glass Lewis & Co., from the proxy rules.

Available Exemptions from the Federal Proxy Rules for Proxy Advisory Firms

As a general proposition, the business of proxy advisory firms would subject them to compliance with the federal proxy rules, as the SEC ordinarily considers the furnishing of proxy voting advice to be a "solicitation" subject to the rules. However, an exemption is available under Rule 14a-2(b)(1) of the Exchange Act to a proxy advisory firm that only distributes reports providing voting recommendations to its client without soliciting the power to act as a proxy for the client. The exemption is not available for a proxy advisory firm offering a service that allows the client to establish, in advance of receiving proxy materials for a particular shareholder meeting, general guidelines or policies that the proxy advisory firm will apply to vote on behalf of the client.

If the exemption provided by 14a-2(b)(1) is not available, then a separate exemption under Rule 14a-2(b)(3) may be available. That rule exempts the furnishing of proxy voting advice by a proxy advisor to another person with whom a business relationship exists, subject to certain conditions, namely that the proxy advisor:

- gives financial advice in the ordinary course of business,
- discloses to the client any significant relationship with the company or any of its affiliates, or with a security holder proponent of the matter on which advice is given, as well as any material interests of the proxy advisor in that matter,
- receives no special commission or remuneration for furnishing the advice from any person other than the client and others who receive similar advice, and
- does not furnish the advice on behalf of any person soliciting proxies or on behalf of a participant in a contested election.

Materiality Standard for Disclosure by the Proxy Advisory Firm

In determining whether its relationship with the company or a security holder proponent is "significant," or whether it has any "material" interest in the matter that is the subject of the voting recommendation, SLB No. 20 requires a proxy advisory firm relying on the Rule 14a-2(b)(3) exemption to consider certain factors. These would include, at a minimum, an evaluation of the type of service being provided in the particular instance, the compensation involved, and the nature of the voting recommendation as it relates to the company and the

shareholders. If the knowledge of a particular interest or relationship could reasonably be expected to affect the voting decision of the client receiving the advice, then the interest or relationship is assumed to be material. If material, the advisory firm must disclose the conflict in sufficient detail to enable the client to grasp the nature and degree of the conflict and how it might potentially affect the proxy advisory firm's voting recommendation.

Provision of Disclosure by the Proxy Advisory Firm

SLB No. 20 makes clear that boilerplate disclosures of proxy advisory firm conflicts are insufficient, even when accompanied by a statement that additional information will be provided on request of the client. Instead, the disclosure must be adequate enough to allow the client to comprehend its impact at the time of receipt of the voting recommendation. However, such disclosure need not be made publicly and may be made in a private communication with the client.

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