Teneo

The Global CEO Advisory Firm

Teneo Insights

SEC Issues New Guidance Affecting Proxy Advisors

August 2019

On August 21, 2019, the Securities and Exchange Commission issued new guidance clarifying the role of proxy advisory firms in the voting process. The guidance has important ramifications for proxy advisory firms and the public companies that are the subjects of their research and recommendations.

While the August 21st guidance addresses investment advisor responsibilities – with specific guidance intended for investors such as mutual funds who utilize proxy advisor services – the bulk of its impact will be directly on leading proxy advisors ISS and Glass Lewis. Specifically, it confirms the interpretation that proxy advisors' advice generally constitutes a "solicitation" under the federal proxy rules, even when the proxy advisor is providing recommendations based on its application of an investor client's own tailored voting guidelines. Further, while the proxy advisory firms may rely on certain exemptions to those rules, they remain subject to a rule prohibiting a solicitation from containing any statement that is "false or misleading with respect to any material fact" and/or from omitting any material fact necessary in order to make the statements therein not false or misleading.

Impact Likely to Be Significant

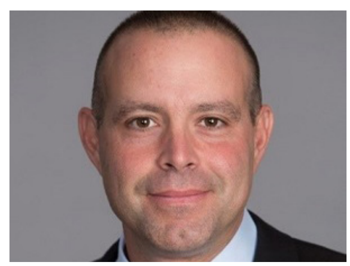
Companies have often been at odds with both ISS and Glass Lewis in arguing that the proxy advisors' research reports either misrepresent or omit key facts that influence investor voting. The latest guidance may expand companies' ability to seek legal redress in some circumstances, and certainly puts more onus on the proxy advisors to present a full and accurate picture of the voting issues they review and opine on.

While it remains to be seen what changes it will make as a result, the guidance could influence ISS' "draft review" process – currently available only to S&P 500 companies – which gives companies an opportunity to correct and comment on their research report (including embedded recommendations) before its release to ISS clients. The new guidance could put pressure on the proxy advisor to make company-requested changes to its report that might otherwise have been deemed "immaterial" by ISS.

Perhaps in anticipation of SEC action, Glass Lewis last year launched a Report Feedback Statement (RFS) service, which gives public companies (and affected shareholder proposal proponents) the opportunity to submit feedback about Glass Lewis' analysis of their proposals, and have those comments delivered directly to the advisor's clients – essentially a "rebuttal" of the Glass Lewis report/ recommendations sent directly to the investors who receive the report. In its current form, the RFS service requires participants to pay a distribution fee and purchase the relevant report

Martha Carter
Senior Managing Director,
Head of Governance Advisory
martha.carter@teneo.com

Carol Bowie
Senior Advisor
Governance Advisory
carol.bowie@teneo.com



Matt Filosa
Managing Director
Governance Advisory
matt.filosa@teneo.com

Sean Quinn
Senior Vice President
Governance Advisory
sean.quinn@teneo.com

directly from Glass Lewis in order to participate. It remains to be seen how that service – or the purchase condition – would be viewed under the new SEC guidance.

Proxy Advisors on the Defensive

In a statement issued on Thursday, August 22, 2019, Glass Lewis CEO Katherine Rabin pointed to the RFS service, along with the company's draft report review [i.e., company reviews of the data Glass has captured for its analysis, to ensure its accuracy] and open-door engagement policies, as tools for issuer understanding and engagement. Although she stated that that the firm will review the clarifications put forth and continue to constructively engage with the SEC, she concluded that, "It is in the best interest of our investor clients to be able to continue to operate our business and offer services in a manner that doesn't compromise the independence, quality and timeliness of the research that Glass Lewis provides."

In a statement cited in an *Agenda* news report, ISS President and CEO Gary Retelny wrote that his firm will "carefully review the guidance issued today to understand the potential impacts for our clients," but initially was concerned that "the guidance will hamper our ability to deliver independent, timely and accurate research, data, insights and perspectives to aid in the discharge of their fiduciary duties."

More to Come

Notably, the two Democratic SEC commissioners – Robert Jackson and Allison Lee – both dissented in the 3-2 vote on the guidance, voicing concern that it would ultimately add to investors' costs to undertake informed proxy voting and result in less competition in the proxy advisor marketplace, but their views are unlikely to prevail. The August 21st SEC guidance is the most recent action stemming from a long-standing campaign (led by the U.S. Chamber of Commerce) to rein in proxy advisors[1], with a promise of more to come. *Agenda* also quoted Chamber spokesperson Erik Rust: "The [proxy solicitation guidance] sets up further work by the SEC for possibly later this year for further requirements proxy advisory firms have to adhere to," Rust [said]. "I think the guidance today sets up the move away from one-size-fits-all voting recommendations for a lot of board issues."

In the meantime, companies should continue to participate in ISS' draft review process if they are eligible to do so, and all companies should request a complimentary copy of their report from ISS.

Teneo will keep clients apprised of further actions and developments in this sphere that could affect their approach to next season's engagement and shareholder meeting activities.

[1]For additional information regarding efforts to regulate proxy advisory firms, see our December 2018 Corporate Governance Update.

Teneo is the global CEO advisory firm.

Working exclusively with the CEOs and senior executives of the world's leading companies, Teneo provides strategic counsel across their full range of key objectives and issues. Our clients include a significant number of the Fortune 100 and FTSE 100, as well as other global corporations.

Integrating the disciplines of strategic communications, investor relations, digital advisory, diversity & inclusion, management consulting, physical & cyber risk advisory, financial advisory, corporate governance advisory, political risk advisory, and talent advisory, Teneo solves for the most complex business challenges and opportunities.

teneo.com