Pearl Meyer

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Update on the Oversight and Regulation of Proxy Advisors



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On June 26, 2024, the US Court of Appeals for the 5th Circuit vacated the rescission in the Security and Exchange Commission's (SEC's) 2022 Final Amendments, which would have required proxy advisory firms to provide their voting advice to companies at the same time as investors, among other forms of regulation. What does that mean for public companies, and specifically their compensation committees? To that end, a chronology of the five-year saga will provide helpful context.

Before 2019

Before 2019, there were no specific rules mandating that proxy advisors like Institutional Shareholder Services (ISS) and Glass Lewis (GL) provide advance reports to the companies they cover. Proxy advisors operated under general guidelines and best practices without any formal regulatory requirements.

SEC Guidance in 2019

In August 2019, the SEC (led by a Trump-appointed commission chair) issued new guidance intended to regulate proxy advisory firms. The guidance clarified that proxy advisors' voting recommendations could be considered "solicitations" under federal proxy rules, thus subjecting them to anti-fraud provisions. The guidance also emphasized the importance of transparency and accuracy in proxy voting advice.

Proposed SEC Rules in 2019

Following the August 2019 guidance, in November 2019, the SEC proposed new rules aimed at increasing the oversight of proxy advisory firms. These proposed rules included a provision for proxy advisors to provide reviewed companies with the advisors' voting advice ("reports") in advance of distributing it to advisors' clients. This proposed rule was intended to give companies a chance to identify any errors or misstatements.

Final SEC Rules in 2020

In July 2020, the SEC adopted "final" new rules that formalized the requirements for proxy advisors. Key provisions included:

- Proxy advisors must provide companies—at no cost—with their reports concurrent with the time it is provided to their clients (i.e., investment advisors).
- Proxy advisors must inform clients if a company provides a rebuttal to the voting advice before the vote.
- Enhanced disclosure requirements were mandated to protect against conflicts of interest.

(To understand the full scope of this rule, see our Client Alert: SEC Adopts Rule Amendments and Provides Supplemental Guidance for Proxy Advisor Voting.)

2021 Updates

In 2021, under the new Biden-appointed SEC leadership, there was a reconsideration of the 2020 Final Rules. The SEC announced that it would not enforce certain provisions of the 2020 rules, particularly the requirements for advance review of reports by companies, pending further regulatory review and potential rulemaking.

2021 Proposed Amendments

In November 2021, the SEC proposed amendments to the 2020 rules, seeking to rescind the requirements for proxy advisors to provide advance reports to companies as well as the requirement that investors be made aware of company rebuttals before the vote. The 2021 proposed amendments aimed to address concerns that the 2020 rules imposed undue burdens on proxy advisors and might interfere with the independent nature of their advice. The Commission was also worried that the rules would impact the timeliness of voting recommendations. The SEC provided a curtailed comment period that spanned the holiday season.

2022 Final Amendments

In July 2022, the SEC finalized the previously proposed amendments to the proxy advisor rules, rescinding the requirement for proxy advisors to provide advance reports to companies. The final amendments focused on ensuring that proxy advisors disclose their

conflicts of interest and provide their clients with transparent and accurate information without the mandatory advance review process. The decision to roll back the rule led two groups—the National Association of Manufacturers and Natural Gas Services Group, Inc.—to challenge these amendments in federal court as violations under the Administrative Procedure Act (APA).

June 2024

The 5th Circuit Court of Appeals reversed the rescission in the 2022 Final Amendments which would have required proxy advisor firms to provide their voting advice to companies at the same time as investors as well as information about company rebuttals before the vote. It said the SEC violated the APA and acted arbitrarily and capriciously when it decided to rescind these rules and it also failed to provide enough evidence to show that the rule would impact the timing of proxy voting advice or independence.

As a result, unless the SEC can offer a better explanation for rolling back the Trump-era requirements, it appears the 2020 Final Rule would be reinstated, requiring that ISS and GL will have to share their voting advice with the companies they are reviewing and give investors information about company rebuttals before the vote.

So, what does that mean today?

At this point, it appears that we are likely going back to the requirements of the 2020 Final Rules requiring proxy advisors to provide no-cost and concurrent reports to companies, as well as information about company rebuttals to its clients.

However, we are essentially in a holding pattern. There is another case pending in the Sixth Circuit and it is possible (although not probable) that the SEC will attempt to reinstate its 2022 amended rules. As the next administration (and perhaps a new roster of SEC commissioners) is to be determined in November, we will need to wait and see whether the reports and rebuttal communications will in fact become requirements in the next proxy season.

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About the Author

Deb advises on executive compensation from a legal and regulatory perspective, including securities disclosure, tax and governance matters, contract negotiation, and reasonableness opinion letters.

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