

## Recent SEC Actions – Clawbacks and Proxy Advisory Firm Regulations

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### Introduction

At the end of June 2020, the Securities and Exchange Commission (SEC) released its Spring Regulatory Flexibility Agenda that provided information regarding the new regulations it would be addressing in the coming year. In this release, the SEC indicated that two important executive compensation issues were included in its agenda: the proposed rules to implement the clawback provisions of the Dodd-Frank legislation<sup>1</sup> and the proposed amendments to exemptions from proxy solicitation rules applicable to proxy voting advice businesses.<sup>2</sup>

The clawback provisions of the Dodd-Frank legislation required the SEC to direct the national securities exchanges to adopt listing standards pertaining to clawbacks. Such rules were proposed by the SEC in 2015,<sup>3</sup> and the SEC has indicated that the revised proposed rules would be issued prior to next spring. With respect to the proxy solicitation rules applicable to the proxy voting advice businesses, the SEC proposed to codify its previous interpretation that proxy voting advice falls within the definition of a solicitation, thereby requiring new disclosure and engagement requirements of the proxy advisory firms. Both Institutional Shareholder Services (ISS) and Glass Lewis have disagreed with this rule-making by the SEC and have sought legal relief from the proxy disclosure requirements.

While we were in the process of writing this Viewpoint, on July 22 the SEC released its proposed final rules governing the proxy advisors that will impact investors who are receiving proxy voting advice provided by ISS and Glass Lewis.<sup>4</sup> These new rules will impose additional disclosure and procedural requirements upon the proxy advisory firms with an aim to ensuring that investors that subscribe to proxy voting advice will receive more accurate, transparent, and complete information.

### Proposed Clawback Policy Rules

In 2015, the SEC proposed new rules directing the national securities exchanges to establish listing standards requiring each issuer to develop and disclose a policy for recoupment of incorrectly paid incentive compensation (“clawback policy”).<sup>3</sup> This was one of the provisions included in Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The clawback rule would supplement existing rules contained in Sarbanes-Oxley (SOX) requiring recoupment of incentive compensation paid to Chief Executive Officers and Chief Financial Officers as well as Item 402(b) of Regulation S-K

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regarding the contents of the Compensation Discussion and Analysis. Recall that SOX requires recoupment in the circumstances of a restatement resulting from misconduct, leading to a material noncompliance of the issuer.

The rules as proposed in 2015 would require issuers to adopt written clawback policies for the recovery of incentive-based compensation that extends beyond the requirements of SOX. The SEC requested comments on the rules after publication in the Federal Register in 2015, received responses from over 60 parties, and held meetings with 10 organizations throughout the spring of 2018. The Commission sought comments on most aspects of the proposed rules including such details as the triggers for recovering incentive compensation, the definition of incentive compensation, the means for determining the amount to be recovered, the definition of covered executives, and means of recovery. (Our Viewpoint with a detailed review of the proposed rules is cited below.<sup>5</sup>) While many clawback policies adopted by companies over the past several years cover a broader group of executives and include trigger events that are more expansive than the proposed rules, companies should monitor the progress of the final rules and anticipate any clawback policy changes needed to ensure compliance.

## New Requirements for Proxy Voting Advice Businesses

In a Federal Register document published on December 4, 2019, the SEC stated that “we are proposing amendments to the federal proxy rules that are designed to ensure the accuracy, transparency of process, and material completeness of the information provided to clients of proxy voting advice businesses when they cast their votes, as well as amendments to enhance disclosure of conflicts of interest that may materially affect the proxy voting advice businesses’ voting advice.”<sup>6</sup> In the past, the proxy voting advice businesses have relied upon the exemptions in Rule 14a-2(b)(1) and Rule 14a-2(b)(3) to provide voting advice without having to comply with the filing and information requirements of the federal proxy rules. Now, the SEC has proposed new conditions to these two exemptions that apply specifically to firms or persons who furnish proxy voting advice that constitutes a solicitation within the scope of the proposed rules. These amendments to the two exemptions applicable to proxy voting advice businesses include:

- (1) **Rule 14a-1(1) – Codifying the SEC’s Interpretation of Solicit and Solicitation** — The SEC will add paragraph A to Rule 14a-1(1)(1)(iii) to clarify that the terms “solicit” and “solicitation” include any proxy voting advice that makes a recommendation to a shareholder as to its vote, consent, or authorization on a specific matter for which shareholder approval is solicited, that is furnished by a person who markets its expertise as a provider of such advice — separately from other forms of investment advice — and who sells such advice for a fee. By codifying its interpretation of solicitation, the SEC has established its basis for oversight of the proxy voting advice businesses and the amendments to the exemption requirements.
- (2) **Rule 14a-2(b) New Information and Disclosure Requirements** — For a proxy voting advice business to comply with the requirements for exemptions to the proxy filing rules, such firms must satisfy the following conditions of new Rule 14a-2(b)(9).
  - Firms must provide detailed information disclosure about any conflicts of interest of the proxy voting advice business that would affect the objectivity and reliability of advice. As an example of a potential conflict of interest, the rules cite a proxy voting advice business or affiliated business that provides advice to its clients on proposals to be considered at the annual meeting of a registrant while the proxy voting advice business also earns fees from that registrant for providing advice on corporate governance or compensation policies.

- Registrants that are subject to proxy voting advice have such advice made to them either before or at the same time such advice is disseminated to the proxy voting advice business's clients. In the past, registrants have reported to the SEC that they have lacked an adequate amount of time and opportunity to review proxy voting advice before it is disseminated and have not been afforded the opportunity to engage with the proxy voting advice business to rectify potential factual errors or methodological weaknesses in the analysis. This new requirement should help to rectify registrants' perceived concerns by establishing a required review and response period, albeit after the proxy advice has already been circulated to investors.
- In addition to the review and response period noted above, the proxy voting advice business must provide registrants with a final notice of voting advice. This notice must be delivered to the investor clients, including any revisions to the advice made during the review and feedback period; such notice must be delivered no later than two days prior to the delivery of the proxy voting advice.
- Registrants will have the option to request that proxy voting advice businesses include with their proxy voting advice a hyperlink or other analogous electronic medium directing the recipient of the advice to a written statement prepared by the registrant setting forth the registrant's views on the advice.

(3) **Rule 14a-9 – Proxy Solicitations Cannot Contain Misleading Information** — The SEC intends to subject the proxy voting advice businesses to the same antifraud standards imposed upon registrants and other soliciting persons for the protection of shareholders. In this regard, proxy voting advice businesses will be required to disclose the methodology used to formulate their proxy voting advice, sources of information on which the advice is based, and material conflicts of interest that have arisen in connection with providing the advice.

The new rules will take effect 60 days after their publication in the Federal Register. The SEC has indicated that the proxy voting advice businesses will not be required to comply with the amendments and new rules until December 1, 2021, thereby making the requirement for compliance delayed until the 2022 proxy season.

We expect that these new rules will have vast implications for the proxy voting advice businesses of ISS and Glass Lewis, and there are numerous questions to be addressed in the coming months. In our mind, some of these questions are:

- What additional staff and resources will ISS and Glass Lewis be required to add to fully meet the new rule requirements?
- Will ISS and Glass Lewis make substantive changes to their financial models and methodologies in the coming months in order to be more transparent in the delivery of voting advice?
- Will registrants take advantage of the new review and feedback requirements and more aggressively challenge voting advice recommendations than they have in the past?
- Will registrants question the methodology, underlying assumptions, and voting advice recommendations of the proxy voting advice businesses even in cases where the voting advice is favorable?
- What conflicts of interest will emerge? For example, could ISS be asked to divest its consulting business unit — ISS Corporate Solutions — to remove a perceived conflict of interest?

## Closing Comments

Based upon our consulting experience, we have found that the majority of large publicly traded companies have developed and implemented clawback policies. Because the SEC is likely to issue proposed final regulations within the next several months, and likely in advance of the 2021 proxy season, it will be incumbent upon companies to review and possibly amend their clawback policies to ensure that they are in full compliance.

The new rules regarding the solicitation and delivery of proxy voting advice by the proxy voting advice businesses, including ISS and Glass Lewis, will be far reaching. In the 2022 proxy season, ISS and Glass Lewis will be required to grant filing companies free access for review and feedback recommendations when the voting advice and accompanying materials are sent out to investors. The proxy voting advice businesses will also need to send the companies' written responses about the voting advice and accompanying materials to their investor clients before they vote on proxies assuming a timely response to the advice by registrants. Clearly, this increased transparency of the proxy voting advice and how such advice was developed will be of direct benefit to most investors.

General questions about this Viewpoint can be directed to Lane Ringlee at [lane.ringlee@paygovernance.com](mailto:lane.ringlee@paygovernance.com) or John Ellerman at [john.ellerman@paygovernance.com](mailto:john.ellerman@paygovernance.com).

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<sup>1</sup> “Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act (RIN: 3235-AL51).” The U.S. Securities and Exchange Commission. June 2020. <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202004&RIN=3235-AL51>.

<sup>2</sup> “Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice (RIN: 3235-AM50).” The U.S. Securities and Exchange Commission. June 2020. <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202004&RIN=3235-AM50>.

<sup>3</sup> “Listing Standards for Recovery of Erroneously Awarded Compensation: A Proposed Rule by the Securities and Exchange Commission.” The Federal Registrar. July 14, 2015. <https://www.federalregister.gov/documents/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation>.

<sup>4</sup> “SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information.” The U.S. Securities and Exchange Commission. July 22, 2020. <https://www.sec.gov/news/press-release/2020-161>.

<sup>5</sup> John R. Ellerman, Bentham W. Stradley, and Lane T. Ringlee. “SEC Proposed New Rules Regarding Executive Compensation Clawback Policies.” Pay Governance. July 14, 2015. <https://www.paygovernance.com/viewpoints/sec-proposed-new-rules-regarding-executive-compensation-clawback-policies>.

<sup>6</sup> “Amendments to Exemptions From the Proxy Rules for Proxy Voting Advice: A Proposed Rule by the Securities and Exchange Commission.” The Federal Register. December 4, 2019. <https://www.federalregister.gov/documents/2019/12/04/2019-24475/amendments-to-exemptions-from-the-proxy-rules-for-proxy-voting-advice>.