

SEC Staff Non-Enforcement of Proxy Advisor Regulations

The Committee on Capital Markets Regulation (the “**Committee**”) is concerned with the June 1 statement by the staff of the Division of Corporation Finance of the U.S. Securities and Exchange Commission (the “**SEC**”) clarifying that it would not recommend an enforcement action against a proxy advisor that fails to comply with certain recently adopted rule amendments governing proxy voting advice (the “**2021 non-enforcement statement**”).¹

In our view, rules adopted by the SEC should be enforced until they are changed through a new rulemaking that follows the Administrative Procedure Act’s (the “**APA’s**”) public notice and comment process.² We therefore recommend that the SEC Division of Corporation Finance withdraw its 2021 non-enforcement statement.

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-nine leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

We begin by briefly reviewing the SEC’s recent proxy advisor reforms and then summarize the 2021 non-enforcement statement by the SEC’s Division of Corporation Finance. Next, we contrast the 2021 non-enforcement statement with the SEC no-action letter process. Then we explain key differences between the 2021 non-enforcement statement and non-enforcement of the SEC’s conflict minerals rules in 2017. We conclude by summarizing our concerns as to the potential impact of the 2021 non-enforcement statement on the regulation of U.S. capital markets.

Recent SEC Proxy Advisor Reforms

For years there has been concern among policymakers regarding the influence of proxy advisors – principally Institutional Shareholder Services (“**ISS**”) and Glass Lewis – over shareholding voting by institutional investors.³ Proxy advisors have been criticized for conflicts of

¹ Division of Corporation Finance, *Public Statement: Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9*, U.S. SEC. & EXCH. COMM’N (June 1, 2021), <https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01>.

² See generally COMMITTEE ON CAPITAL MARKETS REGULATION, *Roadmap for Regulatory Reform*, 23-25 (May 2017), <https://www.capmktreg.org/wp-content/uploads/2018/10/Roadmap-for-Regulatory-Reform.pdf>.

³ See, e.g., Chester S. Spatt, Milken Institute, *Proxy Advisory Firms, Governance, Failure, and Regulation*, HARVARD LAW SCHOOL (June 25, 2019), <https://corpgov.law.harvard.edu/2019/06/25/proxy-advisory-firms-governance-failure-and-regulation/>; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, *GAO-07-765, Corporate Shareholder Meetings: Issues Relating to Firms that Advise Institutional Investors on Proxy Voting* 15-16 (2007) <https://www.gao.gov/new.items/d07765.pdf>.

interest,⁴ limited transparency in how they reach recommendations,⁵ factual errors,⁶ one-size-fits-all methodologies,⁷ and wielding excessive influence with limited accountability.⁸

In July 2020, after protracted debate and public comment, the SEC, then led by former Chairman Walter “Jay” Clayton, adopted rule amendments requiring proxy advisory firms to disclose conflicts of interest and to ensure that proxy voting advice is made available to public companies at or before the time when such advice is disseminated to clients.⁹ The SEC also affirmed by rule its prior interpretation that proxy advisors’ reports are “solicitations,” the effect of which is to subject them to the proxy rules’ anti-fraud provisions.¹⁰ The “solicitation” rule became effective immediately, while the other requirements are not due to become effective until December 1, 2021.¹¹

In October 2019 ISS brought a suit challenging the SEC’s authority to regulate proxy voting advice on the basis that proxy voting advice is not a “solicitation” under the Exchange Act and therefore cannot be regulated as such.¹² By May 2021, the SEC and ISS had both filed motions

⁴ Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 94 (2016). *But see* George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1288-1289 (2014).

⁵ Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 95 (2016).

⁶ Frank M. Placenti, *Are Proxy Advisors Really a Problem?*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Nov. 7, 2018) <https://corpgov.law.harvard.edu/2018/11/07/are-proxy-advisors-really-a-problem/>; Letter from Edwards S. Knight, Exec. V.P., Gen. Counsel & Chief Reg. Officer, NSDAQ OMX, to Elizabeth M. Murphy, SECURITIES AND EXCHANGE COMMISSION 5 (Oct. 8, 2013) <https://perma.cc/7WH2-KWVU>; AMERICAN COUNCIL FOR CAPITAL FORMATION, *Analysis of Proxy Advisor Factual and Analytical Errors in 2016, 2017, and 2018* (Oct. 2018) http://accfcorgov.org/wp-content/uploads/Analysis-of-Proxy-Advisor-Factual-and-Analytical-Errors_October-2018.pdf; SOCIETY OF CORPORATE SECRETARIES & GOVERNANCE PROFESSIONALS, *Letter to the SEC regarding Concept Release on the U.S. Proxy System* (Dec. 27, 2010) <https://www.sec.gov/comments/s7-14-10/s71410-289.pdf>.

⁷ SEC Chairman Jay Clayton, *SEC Rulemaking Over the Past Year*, SECURITIES AND EXCHANGE COMMISSION (Dec. 6, 2018) <https://www.sec.gov/news/speech/speech-clayton-120618>; Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 80 (2016).

⁸ Asaf Eckstein, *Great Expectations: The Peril of an Expectations Gap in Proxy Advisory Firm Regulation*, 40 DEL. J. CORP. L. 77, 95 (2016). *But see* George W. Dent, Jr., *A Defense of Proxy Advisors*, 2014 MICH. ST. L. REV. 1287, 1310-1311 (2014).

⁹ U.S. SEC. & EXCH. COMM’N, *Press Release: SEC Adopts Rule Amendments to Provide Investors Using Proxy Voting Advice More Transparent, Accurate and Complete Information* (July 22, 2020), <https://www.sec.gov/news/press-release/2020-161>; U.S. SEC. & EXCH. COMM’N, *Exemptions From the Proxy Rules for Proxy Voting Advice*, 85 FED. REG. 55082, 55109-55110 (Sept. 3, 2020), <https://www.federalregister.gov/documents/2020/09/03/2020-16337/exemptions-from-the-proxy-rules-for-proxy-voting-advice>. *See also* COMMITTEE ON CAPITAL MARKETS REGULATION, *An Analysis of Investment Stewardship: Mutual Funds & ETFs*, 9-11 (May 2020), <https://www.capmktreg.org/2020/05/19/an-analysis-of-investment-stewardship-mutual-funds-and-etfs/>.

¹⁰ *See* U.S. SEC. & EXCH. COMM’N, *Press Release: SEC Clarifies Investment Advisers’ Proxy Voting Responsibilities and Application of Proxy Rules to Voting Advice* (Aug. 21, 2019), <https://www.sec.gov/news/press-release/2019-158>.

¹¹ U.S. SEC. & EXCH. COMM’N, *Exemptions From the Proxy Rules for Proxy Voting Advice*, 85 FED. REG. 55082, 55122 (Sept. 3, 2020), <https://www.federalregister.gov/documents/2020/09/03/2020-16337/exemptions-from-the-proxy-rules-for-proxy-voting-advice>.

¹² Svea Herbst-Bayliss, *Proxy adviser ISS to push ahead with lawsuit against SEC over new rule*, REUTERS (Aug. 13, 2020), <https://www.reuters.com/article/us-iss-sec-proxy-adviser-iss-to-push-ahead-with-lawsuit-against-sec-over-new-rule-idUSKCN25934B>; Steven Friedman, Institutional Shareholder Services, Inc., *The Basis for ISS’ Lawsuit Against the SEC*, HARVARD LAW SCHOOL (Nov. 5, 2019), <https://corpgov.law.harvard.edu/2019/11/05/the->

for summary judgment, and the court was scheduled to hear oral arguments on these motions on June 7, 2021.¹³

2021 Division of Corporation Finance Non-Enforcement Statement

On June 1, 2021, Chairman Gensler stated that he was directing the SEC staff to consider whether to recommend that the Commission revisit the recent reforms governing proxy voting advice.¹⁴ On that same day, the SEC filed a motion for the court to hold the ISS case in abeyance on the basis that “further regulatory action on the items Chair Gensler has directed staff to consider revisiting could substantially narrow or eliminate the issues raised in the parties’ cross-motions for summary judgment.”¹⁵ The court granted the SEC motion the next day: the ISS case has been stayed until the earlier of January 1, 2022 or the SEC’s promulgation of new proxy rules.

Also on June 1, 2021, the staff of the SEC’s Division of Corporation Finance stated that it would not recommend any enforcement action to the Commission for violations of the recently adopted rules governing proxy voting advice, while the Commission’s reconsideration is underway.¹⁶ The 2021 non-enforcement statement also went further noting that, “in the event that new regulatory action leaves the 2020 exemption conditions in place with the current December 1, 2021 compliance date, the staff will not recommend any enforcement action based on those conditions for a reasonable period of time after any resumption by Institutional Shareholder Services Inc. of its litigation challenging the 2020 amendments and the 2019 Interpretation and Guidance.”¹⁷ However, the staff of the Division of Corporation Finance has not clarified what constitutes a “new regulatory action.” Presumably, a new proposed rule would constitute a new regulatory action. Moreover, the statement does not explain why a “new regulatory action” should trigger a non-enforcement recommendation on the basis of the ISS litigation against the SEC, since the general non-enforcement statement would continue to be in effect.

Distinguishing the 2021 Non-Enforcement Statement from No-Action Letters

When an investor or regulated entity is unsure whether compliance with a specific provision of federal securities law is required in the context of a particular set of facts, it can request

[basis-for-iss-lawsuit-against-the-sec/](#); Cydney Posner, *SEC calls “time out” on proxy advisor guidance and ISS litigation*, COOLEY PUBCO (Jan. 30, 2020), <https://cooleypubco.com/2020/01/30/time-out-on-proxy-advisor-guidance-iss-litigation/>.)

¹³ U.S. SEC. & EXCH. COMM’N, *Unopposed Motion to Hold Case in Abeyance*, Case No. 1:19-cv-3275-APM, Document No. 56 (June 1, 2021), <https://ecf.dcd.uscourts.gov/doc1/04518558774>.

¹⁴ <https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01>

¹⁵ U.S. SEC. & EXCH. COMM’N, *Unopposed Motion to Hold Case in Abeyance*, Case No. 1:19-cv-3275-APM, Document No. 56 (June 1, 2021), <https://ecf.dcd.uscourts.gov/doc1/04518558774>.

¹⁶ Division of Corporation Finance, *Public Statement: Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9*, U.S. SEC. & EXCH. COMM’N (June 1, 2021), <https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01>.

¹⁷ Division of Corporation Finance, *Public Statement: Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9*, U.S. SEC. & EXCH. COMM’N (June 1, 2021), <https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01>.

a no-action letter for clarification from the SEC staff.¹⁸ As described by the SEC, “no-action letters describe the request, analyze the particular facts and circumstances involved, discuss applicable laws and rules, and, if the staff grants the request for no action, concludes that the SEC staff would not recommend that the [SEC] take enforcement action against the requester based on the facts and representations described in the individual’s or entity’s request.”¹⁹ However, the 2021 non-enforcement statement goes well beyond the parameters of a no-action letter. The statement was *not* issued at the request of a private party to resolve legal ambiguity; it is not limited to a specific set of facts; and it offers no legal analysis as to how existing rules apply in context. Instead, the 2021 non-enforcement statement is a broad non-enforcement policy under all circumstances.

SEC Conflict Minerals Rule

The Dodd-Frank Act of 2010 directed the SEC to issue rules requiring public companies to disclose their use of conflict minerals out of concern that trade in these minerals by armed groups was helping to fuel conflict in the Democratic Republic of the Congo (“**DRC**”).²⁰ In 2012, the SEC then adopted a requirement that companies issue “Conflict Minerals Reports” that, among other things, designate minerals of undetermined origin as “not found to be DRC conflict free.”²¹ In 2015, the D.C. Circuit held that, although the general requirement for a Conflicts Mineral Report was otherwise valid, the specific requirement that issuers designate certain minerals as “not found to be DRC conflict free” amounted to compelled speech that violates the First Amendment.²² Following the final judgment, then Acting SEC Chairman Michael Piwowar indicated that the SEC would revisit the conflict minerals rules,²³ and the Division of Corporation Finance stated that it would not enforce the failure to file a Conflict Minerals Report, even though the courts had only invalidated one portion of the Report requirement.²⁴

There is a crucial difference between the non-enforcement of compliance with filing a Conflict Minerals Report and the proxy advisor regulations at issue here. In the case of the Conflict Minerals Report, there was a credible argument that the SEC should not enforce a rule of which an important element – some would say the critical element – had been invalidated by the courts.

¹⁸ U.S. SEC. & EXCH. COMM’N, *No Action Letters* (last accessed June 14, 2021),

<https://www.investor.gov/introduction-investing/investing-basics/glossary/no-action-letters>.

¹⁹ U.S. SEC. & EXCH. COMM’N, *No Action Letters* (last accessed June 14, 2021),

<https://www.investor.gov/introduction-investing/investing-basics/glossary/no-action-letters>.

²⁰ U.S. SEC. & EXCH. COMM’N, *Fact Sheet: Disclosing the Use of Conflict Minerals* (March 14, 2017),

<https://www.sec.gov/opa/Article/2012-2012-163htm---related-materials.html>.

²¹ U.S. SEC. & EXCH. COMM’N, *Conflict Minerals*, Release No. 34-67716, File No. S7-40-10 (Aug. 22, 2012),

<https://www.sec.gov/rules/final/2012/34-67716.pdf>.

²² *Nat’l Ass’n of Mfrs., et al. v. SEC*, 800 F.3d 518, 530 (D.C. Cir 2015). *See also* Division of Corporation Finance, *Public Statement: Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule*,

U.S. SEC. & EXCH. COMM’N (April 7, 2017), <https://www.sec.gov/news/public-statement/corpfin-updated-statement-court-decision-conflict-minerals-rule>.

²³ Acting Chairman Michael S. Piwowar, *Public Statement: Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule*, U.S. SEC. & EXCH. COMM’N (April 7, 2017),

<https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule>.

²⁴ Division of Corporation Finance, *Public Statement: Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule*, U.S. SEC. & EXCH. COMM’N (April 7, 2017),

<https://www.sec.gov/news/public-statement/corpfin-updated-statement-court-decision-conflict-minerals-rule>.

On the other hand, there has been no determination, judicial or otherwise, that the proxy advisor regulations are invalid or unenforceable, in whole or in part.

Conclusion

The Committee believes that the SEC staff should enforce rules that have been adopted by the Commission. If the Commission seeks to revise the 2020 proxy advisor reforms, then it must do so through the APA's notice and comment process.²⁵ Furthermore, as noted earlier, the 2021 non-enforcement statement also clarifies that if ISS were to resume its lawsuit against the SEC challenging those rules, then the relevant proxy rules would not be enforced for a reasonable period of time after the case is resumed. If the new policy of the SEC is to not enforce rules while they are being challenged in litigation, it may be an open invitation for parties to bring legal challenges against rules to avoid their enforcement. We are further concerned that the use of non-enforcement statements could spread to other SEC rulemakings and even to other independent agencies that regulate the financial system, undermining proper regulatory processes and the rule of law. We therefore recommend that the SEC Division of Corporation Finance withdraw its 2021 non-enforcement statement.

²⁵ We note that the Commission did not seek to immediately revise the 2020 proxy advisor reforms through an "interim-final" rulemaking without a notice-and-comment period. Since the APA only exempts rulemakings from the notice and comment process "when the agency for good cause finds...that notice and public procedure are *impracticable, unnecessary or contrary to the public interest,*" it is unlikely that revisions to the 2020 proxy advisor reforms would meet such a standard.