H. R. 5311

[Report No. 114–798]

To improve the quality of proxy advisory firms for the protection of investors and the U.S. economy, and in the public interest, by fostering accountability, transparency, responsiveness, and competition in the proxy advisory firm industry.

IN THE HOUSE OF REPRESENTATIVES

MAY 24, 2016

Mr. DUFFY (for himself and Mr. CARNEY) introduced the following bill; which was referred to the Committee on Financial Services

SEPTEMBER 28, 2016

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed

[Strike out all after the enacting clause and insert the part printed in italic]

[For text of introduced bill, see copy of bill as introduced on May 24, 2016]
A BILL

To improve the quality of proxy advisory firms for the protection of investors and the U.S. economy, and in the public interest, by fostering accountability, transparency, responsiveness, and competition in the proxy advisory firm industry.
Be it enacted by the Senate and House of Representa-
tives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the “Corporate Governance
Reform and Transparency Act of 2016”.

SEC. 2. DEFINITIONS.

(a) Securities Exchange Act of 1934.—Section
78c(a)) is amended by adding at the end the following new
paragraphs:

“(81) Proxy advisory firm.—The term ‘proxy
advisory firm’ means any person registered under sec-
tion 15H who is engaged in the business of providing
proxy voting research, analysis, or recommendations
to clients, which conduct constitutes a solicitation
within the meaning of section 14 and the Commis-
sion’s rules and regulations thereunder, except to the
extent that the person is exempted by such rules and
regulations from requirements otherwise applicable to
persons engaged in a solicitation.

“(82) Person associated with a proxy advi-
sory firm.—The term ‘person associated with’ a
proxy advisory firm means any partner, officer, or
director of a proxy advisory firm (or any person oc-
cupying a similar status or performing similar func-
tions), any person directly or indirectly controlling, controlled by, or under common control with a proxy advisory firm, or any employee of a proxy advisory firm, except that persons associated with a proxy advisory firm whose functions are clerical or ministerial shall not be included in the meaning of such term. The Commission may by rules and regulations classify, for purposes or any portion or portions of this Act, persons, including employees controlled by a proxy advisory firm.”.

(b) APPLICABLE DEFINITIONS.—As used in this Act—

(1) the term “Commission” means the Securities and Exchange Commission; and

(2) the term “proxy advisory firm” has the same meaning as in section 3(a)(81) of the Securities Exchange Act of 1934, as added by this Act.

SEC. 3. REGISTRATION OF PROXY ADVISORY FIRMS.

(a) AMENDMENT.—The Securities Exchange Act of 1934 is amended by inserting after section 15G the following new section:

“SEC. 15H. REGISTRATION OF PROXY ADVISORY FIRMS.

“(a) CONDUCT PROHIBITED.—It shall be unlawful for a proxy advisory firm to make use of the mails or any means or instrumentality of interstate commerce to provide proxy voting research, analysis, or recommendations to any
client, unless such proxy advisory firm is registered under this section.

“(b) Registration Procedures.—

“(1) Application for Registration.—

“(A) In general.—A proxy advisory firm must file with the Commission an application for registration, in such form as the Commission shall require, by rule or regulation, and containing the information described in subparagraph (B).

“(B) Required Information.—An application for registration under this section shall contain information regarding—

“(i) a certification that the applicant has adequate financial and managerial resources to consistently provide proxy advice based on accurate information;

“(ii) the procedures and methodologies that the applicant uses in developing proxy voting recommendations, including whether and how the applicant considers the size of a company when making proxy voting recommendations;

“(iii) the organizational structure of the applicant;
“(iv) whether or not the applicant has in effect a code of ethics, and if not, the reasons therefor;

“(v) any potential or actual conflict of interest relating to the ownership structure of the applicant or the provision of proxy advisory services by the applicant, including whether the proxy advisory firm engages in services ancillary to the provision of proxy advisory services such as consulting services for corporate issuers, and if so the revenues derived therefrom;

“(vi) the policies and procedures in place to manage conflicts of interest under subsection (f); and

“(vii) any other information and documents concerning the applicant and any person associated with such applicant as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

“(2) REVIEW OF APPLICATION.—

“(A) INITIAL DETERMINATION.—Not later than 90 days after the date on which the application for registration is filed with the Commis-
sion under paragraph (1) (or within such longer period as to which the applicant consents) the Commission shall—

“(i) by order, grant registration; or
“(ii) institute proceedings to determine whether registration should be denied.

“(B) CONDUCT OF PROCEEDINGS.——
“(i) CONTENT.—Proceedings referred to in subparagraph (A)(ii) shall—

“(I) include notice of the grounds for denial under consideration and an opportunity for hearing; and
“(II) be concluded not later than 120 days after the date on which the application for registration is filed with the Commission under paragraph (1).

“(ii) DETERMINATION.—At the conclusion of such proceedings, the Commission, by order, shall grant or deny such application for registration.

“(iii) EXTENSION AUTHORIZED.—The Commission may extend the time for conclusion of such proceedings for not longer than 90 days, if it finds good cause for such
extension and publishes its reasons for so finding, or for such longer period as to which the applicant consents.

“(C) GROUNDS FOR DECISION.—The Commission shall grant registration under this subsection—

“(i) if the Commission finds that the requirements of this section are satisfied; and

“(ii) unless the Commission finds (in which case the Commission shall deny such registration) that—

“(I) the applicant has failed to certify to the Commission’s satisfaction that it has adequate financial and managerial resources to consistently provide proxy advice based on accurate information and to materially comply with the procedures and methodologies disclosed under paragraph (1)(B) and subsections (f) and (g); or

“(II) if the applicant were so registered, its registration would be subject to suspension or revocation under subsection (e).
“(3) PUBLIC AVAILABILITY OF INFORMATION.—

Subject to section 24, the Commission shall make the information and documents submitted to the Commission by a proxy advisory firm in its completed application for registration, or in any amendment submitted under paragraph (1) or (2) of subsection (c), publicly available on the Commission’s website, or through another comparable, readily accessible means.

“(c) UPDATE OF REGISTRATION.—

“(1) UPDATE.—Each registered proxy advisory firm shall promptly amend and update its application for registration under this section if any information or document provided therein becomes materially inaccurate, except that a registered proxy advisory firm is not required to amend the information required to be filed under subsection (b)(1)(B)(i) by filing information under this paragraph, but shall amend such information in the annual submission of the organization under paragraph (2) of this subsection.

“(2) CERTIFICATION.—Not later than 90 calendar days after the end of each calendar year, each registered proxy advisory firm shall file with the Commission an amendment to its registration, in such form as the Commission, by rule, may prescribe.
as necessary or appropriate in the public interest or for the protection of investors—

“(A) certifying that the information and documents in the application for registration of such registered proxy advisory firm continue to be accurate in all material respects; and

“(B) listing any material change that occurred to such information or documents during the previous calendar year.

“(d) Censure, Denial, or Suspension of Registration; Notice and Hearing.—The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding 12 months, or revoke the registration of any registered proxy advisory firm if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is necessary for the protection of investors and in the public interest and that such registered proxy advisory firm, or any person associated with such an organization, whether prior to or subsequent to becoming so associated—

“(1) has committed or omitted any act, or is subject to an order or finding, enumerated in subparagraph (A), (D), (E), (H), or (G) of section 15(b)(4), has been convicted of any offense specified in
section 15(b)(4)(B), or is enjoined from any action, conduct, or practice specified in subparagraph (C) of section 15(b)(4), during the 10-year period preceding the date of commencement of the proceedings under this subsection, or at any time thereafter;

“(2) has been convicted during the 10-year period preceding the date on which an application for registration is filed with the Commission under this section, or at any time thereafter, of—

“(A) any crime that is punishable by imprisonment for one or more years, and that is not described in section 15(b)(4)(B); or

“(B) a substantially equivalent crime by a foreign court of competent jurisdiction;

“(3) is subject to any order of the Commission barring or suspending the right of the person to be associated with a registered proxy advisory firm;

“(4) fails to furnish the certifications required under subsections (b)(2)(C)(ii)(I) and (c)(2);

“(5) has engaged in one or more prohibited acts enumerated in paragraph (1); or

“(6) fails to maintain adequate financial and managerial resources to consistently offer advisory services with integrity, including by failing to comply with subsections (f) or (g).
“(e) TERMINATION OF REGISTRATION.—

“(1) VOLUNTARY WITHDRAWAL.—A registered proxy advisory firm may, upon such terms and conditions as the Commission may establish as necessary in the public interest or for the protection of investors, which terms and conditions shall include at a minimum that the registered proxy advisory firm will no longer conduct such activities as to bring it within the definition of proxy advisory firm in section 3(a)(81) of the Securities Exchange Act of 1934, withdraw from registration by filing a written notice of withdrawal to the Commission.

“(2) COMMISSION AUTHORITY.—In addition to any other authority of the Commission under this title, if the Commission finds that a registered proxy advisory firm is no longer in existence or has ceased to do business as a proxy advisory firm, the Commission, by order, shall cancel the registration under this section of such registered proxy advisory firm.

“(f) MANAGEMENT OF CONFLICTS OF INTEREST.—

“(1) ORGANIZATION POLICIES AND PROCEDURES.—Each registered proxy advisory firm shall establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such registered
proxy advisory firm and associated persons, to address and manage any conflicts of interest that can arise from such business.

“(2) COMMISSION AUTHORITY.—The Commission shall issue final rules to prohibit, or require the management and disclosure of, any conflicts of interest relating to the offering of proxy advisory services by a registered proxy advisory firm, including, without limitation, conflicts of interest relating to—

“(A) the manner in which a registered proxy advisory firm is compensated by the client, or any affiliate of the client, for providing proxy advisory services;

“(B) the provision of consulting, advisory, or other services by a registered proxy advisory firm, or any person associated with such registered proxy advisory firm, to the client;

“(C) business relationships, ownership interests, or any other financial or personal interests between a registered proxy advisory firm, or any person associated with such registered proxy advisory firm, and any client, or any affiliate of such client;

“(D) transparency around the formulation of proxy voting policies;
“(E) the execution of proxy votes if such votes are based upon recommendations made by the proxy advisory firm in which someone other than the issuer is a proponent;

“(F) issuing recommendations where proxy advisory firms provide advisory services to a company; and

“(G) any other potential conflict of interest, as the Commission deems necessary or appropriate in the public interest or for the protection of investors.

“(g) RELIABILITY OF PROXY ADVISORY FIRM SERVICES.—

“(1) IN GENERAL.—Each registered proxy advisory firm shall have staff sufficient to produce proxy voting recommendations that are based on accurate and current information. Each registered proxy advisory firm shall detail procedures sufficient to permit companies receiving proxy advisory firm recommendations access in a reasonable time to the draft recommendations, with an opportunity to provide meaningful comment thereon, including the opportunity to present details to the person responsible for developing the recommendation in person or telephonically. Each registered proxy advisory firm shall
employ an ombudsman to receive complaints about
the accuracy of voting information used in making
recommendations from the subjects of the proxy advi-
sory firm’s voting recommendations, and shall resolve
those complaints in a timely fashion and in any
event prior to voting on the matter to which the rec-
ommendation relates.

“(2)Draft recommendations defined.—For
purposes of this subsection, the term ‘draft rec-
ommendations’—

“(A) means the overall conclusions of proxy
voting recommendations prepared for the clients
of a proxy advisory firm, including any public
data cited therein, any company information or
substantive analysis impacting the recommenda-
tion, and the specific voting recommendations on
individual proxy ballot issues; and

“(B) does not include the entirety of the
proxy advisory firm’s final report to its clients.

“(h)Designation of Compliance Officer.—Each
registered proxy advisory firm shall designate an indi-
vidual responsible for administering the policies and proce-
dures that are required to be established pursuant to sub-
sections (f) and (g), and for ensuring compliance with the
securities laws and the rules and regulations thereunder,
• including those promulgated by the Commission pursuant to this section.

“(i) PROHIBITED CONDUCT.—

“(1) PROHIBITED ACTS AND PRACTICES.—The Commission shall issue final rules to prohibit any act or practice relating to the offering of proxy advisory services by a registered proxy advisory firm that the Commission determines to be unfair, coercive, or abusive, including any act or practice relating to—

“(A) conditioning a voting recommendation or other proxy advisory firm recommendation on the purchase by an issuer or an affiliate thereof of other services or products, of the registered proxy advisory firm or any person associated with such registered proxy advisory firm; and

“(B) modifying a voting recommendation or otherwise departing from its adopted systematic procedures and methodologies in the provision of proxy advisory services, based on whether an issuer, or affiliate thereof, subscribes or will subscribe to other services or product of the registered proxy advisory firm or any person associated with such organization.

“(2) RULE OF CONSTRUCTION.—Nothing in paragraph (1), or in any rules or regulations adopted
thereunder, may be construed to modify, impair, or
supersede the operation of any of the antitrust laws
(as defined in the first section of the Clayton Act, ex-
cept that such term includes section 5 of the Federal
Trade Commission Act, to the extent that such section
5 applies to unfair methods of competition).

“(j) Statements of Financial Condition.—Each
registered proxy advisory firm shall, on a confidential
basis, file with the Commission, at intervals determined by
the Commission, such financial statements, certified (if re-
quired by the rules or regulations of the Commission) by
an independent public auditor, and information concerning
its financial condition, as the Commission, by rule, may
prescribe as necessary or appropriate in the public interest
or for the protection of investors.

“(k) Annual Report.—Each registered proxy advi-
sory firm shall, at the beginning of each fiscal year of such
firm, report to the Commission on the number of share-
holder proposals its staff reviewed in the prior fiscal year,
the number of recommendations made in the prior fiscal
year, the number of staff who reviewed and made rec-
ommendations on such proposals in the prior fiscal year,
and the number of recommendations made in the prior fis-
cal year where the proponent of such recommendation was
a client of or received services from the proxy advisory firm.
“(l) **TRANSPARENT POLICIES.**—Each registered proxy advisory firm shall file with the Commission and make publicly available its methodology for the formulation of proxy voting policies and voting recommendations.

“(m) **RULES OF CONSTRUCTION.**—

“(1) **NO WAIVER OF RIGHTS, PRIVILEGES, OR DEFENSES.**—Registration under and compliance with this section does not constitute a waiver of, or otherwise diminish, any right, privilege, or defense that a registered proxy advisory firm may otherwise have under any provision of State or Federal law, including any rule, regulation, or order thereunder.

“(2) **NO PRIVATE RIGHT OF ACTION.**—Nothing in this section may be construed as creating any private right of action, and no report filed by a registered proxy advisory firm in accordance with this section or section 17 shall create a private right of action under section 18 or any other provision of law.

“(n) **REGULATIONS.**—

“(1) **NEW PROVISIONS.**—Such rules and regulations as are required by this section or are otherwise necessary to carry out this section, including the application form required under subsection (a)—
“(A) shall be issued by the Commission, not later than 180 days after the date of enactment of this section; and

“(B) shall become effective not later than 1 year after the date of enactment of this section.

“(2) Review of existing regulations.—Not later than 270 days after the date of enactment of this section, the Commission shall—

“(A) review its existing rules and regulations which affect the operations of proxy advisory firms;

“(B) amend or revise such rules and regulations in accordance with the purposes of this section, and issue such guidance, as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors; and

“(C) direct Commission staff to withdraw the Egan Jones Proxy Services (May 27, 2004) and Institutional Shareholder Services, Inc. (September 15, 2004) no-action letters.

“(o) Applicability.—This section, other than subsection (n), which shall apply on the date of enactment of this section, shall apply on the earlier of—
“(1) the date on which regulations are issued in final form under subsection (n)(1); or

“(2) 270 days after the date of enactment of this section.”.

(b) Conforming Amendment.—Section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)) is amended by inserting “proxy advisory firm,” after “nation- tionally recognized statistical rating organization,“.

SEC. 4. COMMISSION ANNUAL REPORT.

The Commission shall make an annual report publicly available on the Commission’s Internet website. Such report shall, with respect to the year to which the report relates—

(1) identify applicants for registration under section 15H of the Securities Exchange Act of 1934, as added by this Act;

(2) specify the number of and actions taken on such applications;

(3) specify the views of the Commission on the state of competition, transparency, policies and methodologies, and conflicts of interest among proxy advisory firms;

(4) include the determination of the Commission with regards to—

(A) the quality of proxy advisory services issued by proxy advisory firms;
(B) the financial markets;

(C) competition among proxy advisory firms;

(D) the incidence of undisclosed conflicts of interest by proxy advisory firms;

(E) the process for registering as a proxy advisory firm; and

(F) such other matters relevant to the implementation of this Act and the amendments made by this Act, as the Commission determines necessary to bring to the attention of the Congress;

(5) identify problems, if any, that have resulted from the implementation of this Act and the amendments made by this Act; and

(6) recommend solutions, including any legislative or regulatory solutions, to any problems identified under paragraphs (4) and (5).
A BILL

To improve the quality of proxy advisory firms for the protection of investors and the U.S. economy, and in the public interest, by fostering accountability, transparency, responsiveness, and competition in the proxy advisory firm industry.

SEPTEMBER 28, 2016

Reported with an amendment, committed to the Committee of the Whole House on the State of the Union, and ordered to be printed.