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(Original Signature of Member)

114TH CONGRESS
1ST SESSION

H. R.

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

Mr. DUFFY introduced the following bill; which was referred to the Committee
on _____

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.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “Proxy Advisory Firm
5 Reform Act of 2016”.

1 **SEC. 2. FINDINGS.**

2 Upon the basis of facts disclosed by the record, com-
3 ment letters to, and a roundtable held by, the Securities
4 and Exchange Commission, and facts otherwise disclosed
5 and ascertained, Congress finds that the role of proxy ad-
6 visory firms in the U.S. economy is of national impor-
7 tance, in that, among other things—

8 (1) their suggestions, writings, analyses, and re-
9 ports are furnished and distributed, and their con-
10 tracts and other arrangements with clients are nego-
11 tiated and performed, by the use of the mails and
12 other means and instrumentalities of interstate com-
13 merce;

14 (2) their publications, writings, analyses, and
15 reports customarily relate to key proxy voting func-
16 tions such as making recommendations to their cli-
17 ents, which are primarily institutional investors and
18 other shareholders, as to how to vote issuers' prox-
19 ies, and assisting their clients in carrying out those
20 votes, in respect of matters such as fundamental
21 corporate transactions like mergers or acquisitions,
22 the approval of corporate directors whether nomi-
23 nated by the company or a dissident that is mount-
24 ing a proxy campaign, and shareholder proposals;

25 (3) their process for formulating voting guide-
26 lines, and then recommending votes based on those

1 guidelines, has assumed outsized importance in the
2 national debate over high-quality corporate govern-
3 ance;

4 (4) their advice is used by some investors as
5 one point of reference out of many in making voting
6 decisions, while other investors may be overly reliant
7 on the voting advice of proxy advisory firms as com-
8 pared to portfolio managers who have a fiduciary
9 duty to their investors in exercising its shareholder
10 votes and use independent judgement in doing so;

11 (5) the foregoing occur in such volume as sub-
12 stantially to affect corporate governance, the securi-
13 ties markets, and the national economy;

14 (6) the largest proxy advisory firms serve the
15 vast majority of the market, and additional competi-
16 tion is in the public interest;

17 (7) oversight of such proxy advisory firms
18 serves the compelling interest of investor and share-
19 holder protection; and

20 (8) the Commission needs statutory authority
21 to oversee the proxy advisory firm industry.

22 **SEC. 3. DEFINITIONS.**

23 (a) SECURITIES EXCHANGE ACT OF 1934.—Section
24 3(a) of the Securities Exchange Act of 1934 (15 U.S.C.

1 78c(a)) is amended by adding at the end the following new
2 paragraphs:

3 “(81) PROXY ADVISORY FIRM.—The term
4 ‘proxy advisory firm’ means any person engaged in
5 the business of providing proxy voting research,
6 analysis, and recommendations to investors in public
7 companies, which conduct constitutes a solicitation
8 within the meaning of section 14 and the Commis-
9 sion’s rules and regulations thereunder, except to
10 the extent that the person is exempted by such rules
11 and regulations from requirements otherwise appli-
12 cable to persons engaged in a solicitation.

13 “(82) REGISTERED PROXY ADVISORY FIRM.—
14 The term ‘registered proxy advisory firm’ means a
15 proxy advisory firm that is registered under section
16 15H.

17 “(83) PERSON ASSOCIATED WITH A REG-
18 ISTERED PROXY ADVISORY FIRM.—The term ‘person
19 associated with’ a registered proxy advisory firm
20 means any partner, officer, or director of a reg-
21 istered proxy advisory firm (or any person occupying
22 a similar status or performing similar functions),
23 any person directly or indirectly controlling, con-
24 trolled by, or under common control with a reg-

1 istered proxy advisory firm, or any employee of a
2 registered proxy advisory firm.”.

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

5 (1) the term “Commission” means the Securi-
6 ties and Exchange Commission; and

7 (2) the term “registered proxy advisory firm”
8 has the same meaning as in section 3(a)(82) of the
9 Securities Exchange Act of 1934, as added by this
10 Act.

11 **SEC. 4. REGISTRATION OF REGISTERED PROXY ADVISORY**
12 **FIRMS.**

13 (a) AMENDMENT.—The Securities Exchange Act of
14 1934 is amended by inserting after section 15G the fol-
15 lowing new section:

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

17 “(a) CONDUCT PROHIBITED.—It shall be unlawful
18 for a proxy advisory firm to make use of the mails or any
19 means or instrumentality of interstate commerce to pro-
20 vide proxy voting research, analysis, and recommendations
21 to any client, unless such proxy advisory firm is registered
22 under this section.

23 “(b) REGISTRATION PROCEDURES.—

24 “(1) APPLICATION FOR REGISTRATION.—

1 “(A) IN GENERAL.—A proxy advisory firm
2 must furnish to the Commission an application
3 for registration, in such form as the Commis-
4 sion shall require, by rule or regulation issued
5 in accordance with subsection (m), and con-
6 taining the information described in subpara-
7 graph (B).

8 “(B) REQUIRED INFORMATION.—An appli-
9 cation for registration under this section shall
10 contain information regarding—

11 “(i) the procedures and methodologies
12 that the applicant uses in advising their
13 clients, including whether and how the ap-
14 plicant considers the size of a company
15 when making proxy voting recommenda-
16 tions;

17 “(ii) the organizational structure of
18 the applicant;

19 “(iii) whether or not the applicant has
20 in effect a code of ethics, and if not, the
21 reasons therefor;

22 “(iv) any potential or actual conflict
23 of interest relating to the ownership struc-
24 ture of the applicant or the issuance of

1 proxy advisory services by the applicant,
2 including—

3 “(I) whether the proxy advisory
4 firm engages in services ancillary to
5 the provision of proxy advisory serv-
6 ices such as consulting services for
7 corporate issuers, and if so the reve-
8 nues derived therefrom; and

9 “(II) a list of the 20 largest cli-
10 ents (which list may be granted con-
11 fidential treatment) that use the
12 proxy advisory services of the appli-
13 cant, by amount of net revenues re-
14 ceived therefrom in the fiscal year im-
15 mediately preceding the date of sub-
16 mission of the application, and the
17 policies and procedures in place to
18 prevent such clients from having an
19 undue influence on the formulation of
20 proxy voting policies;

21 “(v) the policies and procedures in
22 place to manage conflicts of interest under
23 subsection (g); and

24 “(vi) any other information and docu-
25 ments concerning the applicant and any

1 person associated with such applicant as
2 the Commission, by rule, may prescribe as
3 necessary or appropriate in the public in-
4 terest or for the protection of investors.

5 “(2) REVIEW OF APPLICATION.—

6 “(A) INITIAL DETERMINATION.—Not later
7 than 90 days after the date on which the appli-
8 cation for registration is furnished to the Com-
9 mission under paragraph (1) (or within such
10 longer period as to which the applicant con-
11 sents) the Commission shall—

12 “(i) by order, grant registration; or

13 “(ii) institute proceedings to deter-
14 mine whether registration should be de-
15 nied.

16 “(B) CONDUCT OF PROCEEDINGS.—

17 “(i) CONTENT.—Proceedings referred
18 to in subparagraph (A)(ii) shall—

19 “(I) include notice of the grounds
20 for denial under consideration and an
21 opportunity for hearing; and

22 “(II) be concluded not later than
23 120 days after the date on which the
24 application for registration is fur-

1 nished to the Commission under para-
2 graph (1).

3 “(ii) DETERMINATION.—At the con-
4 clusion of such proceedings, the Commis-
5 sion, by order, shall grant or deny such ap-
6 plication for registration.

7 “(iii) EXTENSION AUTHORIZED.—The
8 Commission may extend the time for con-
9 clusion of such proceedings for not longer
10 than 90 days, if it finds good cause for
11 such extension and publishes its reasons
12 for so finding, or for such longer period as
13 to which the applicant consents.

14 “(C) GROUNDS FOR DECISION.—The Com-
15 mission shall grant registration under this sub-
16 section—

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

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

23 “(I) the applicant does not have
24 adequate financial and managerial re-
25 sources to consistently produce proxy

1 advisory services with accuracy and
2 integrity and to materially comply
3 with the procedures and methodolo-
4 gies disclosed under paragraph (1)(B)
5 and with subsections (g) and (h); or

6 “(II) if the applicant were so reg-
7 istered, its registration would be sub-
8 ject to suspension or revocation under
9 subsection (e).

10 “(3) PUBLIC AVAILABILITY OF INFORMATION.—

11 Subject to section 24, the Commission shall, by rule,
12 require a proxy advisory firm upon the granting of
13 registration under this section, to make the informa-
14 tion and documents submitted to the Commission in
15 its completed application for registration, or in any
16 amendment submitted under paragraph (1) or (2) of
17 subsection (c), publicly available on its website, or
18 through another comparable, readily accessible
19 means, except as provided in paragraph (1)(B).

20 “(c) UPDATE OF REGISTRATION.—

21 “(1) UPDATE.—Each registered proxy advisory
22 firm shall promptly amend its application for reg-
23 istration under this section if any information or
24 document provided therein becomes materially inac-
25 curate, except that a registered proxy advisory firm

1 is not required to amend the information required to
2 be furnished under subsection (a)(1)(B)(i) by fur-
3 nishing information under this paragraph, but shall
4 amend such information in the annual submission of
5 the organization under paragraph (2) of this sub-
6 section; or

7 “(2) CERTIFICATION.—Not later than 90 days
8 after the end of each calendar year, each registered
9 proxy advisory firm shall furnish to the Commission
10 an amendment to its registration, in such form as
11 the Commission, by rule, may prescribe as necessary
12 or appropriate in the public interest or for the pro-
13 tection of investors—

14 “(A) certifying that the information and
15 documents in the application for registration of
16 such registered proxy advisory firm continue to
17 be accurate; and

18 “(B) listing any material change that oc-
19 curred to such information or documents during
20 the previous calendar year.

21 “(d) CENSURE, DENIAL, OR SUSPENSION OF REG-
22 ISTRATION; NOTICE AND HEARING.—The Commission, by
23 order, shall censure, place limitations on the activities,
24 functions, or operations of, suspend for a period not ex-
25 ceeding 12 months, or revoke the registration of any reg-

1 istered proxy advisory firm if the Commission finds, on
2 the record after notice and opportunity for hearing, that
3 such censure, placing of limitations, suspension, or revoca-
4 tion is necessary for the protection of investors and in the
5 public interest and that such registered proxy advisory
6 firm, or any person associated with such an organization,
7 whether prior to or subsequent to becoming so associ-
8 ated—

9 “(1) has committed or omitted any act, or is
10 subject to an order or finding, enumerated in sub-
11 paragraph (A), (D), (E), (H), or (G) of section
12 15(b)(4), has been convicted of any offense specified
13 in section 15(b)(4)(B), or is enjoined from any ac-
14 tion, conduct, or practice specified in subparagraph
15 (C) of section 15(b)(4), during the 10-year period
16 preceding the date of commencement of the pro-
17 ceedings under this subsection, or at any time there-
18 after;

19 “(2) has been convicted during the 10-year pe-
20 riod preceding the date on which an application for
21 registration is furnished to the Commission under
22 this section, or at any time thereafter, of—

23 “(A) any crime that is punishable by im-
24 prisonment for 1 or more years, and that is not
25 described in section 15(b)(4)(B); or

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

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

6 “(4) fails to furnish the certifications required
7 under subsection (c)(2);

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

10 “(6) fails to maintain adequate financial and
11 managerial resources to consistently offer advisory
12 services with integrity, including by failing to comply
13 with subsections (g) or (h).

14 “(f) TERMINATION OF REGISTRATION.—

15 “(1) VOLUNTARY WITHDRAWAL.—A registered
16 proxy advisory firm may, upon such terms and con-
17 ditions as the Commission may establish as nec-
18 essary in the public interest or for the protection of
19 investors, which terms and conditions shall include
20 at a minimum that the registered proxy advisory
21 firm will no longer conduct such activities as to
22 bring it within the definition of proxy advisory firm
23 in section 3(a)(81) of the Exchange Act, withdraw
24 from registration by furnishing a written notice of
25 withdrawal to the Commission.

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

8 “(g) MANAGEMENT OF CONFLICTS OF INTEREST.—

9 “(1) ORGANIZATION POLICIES AND PROCE-
10 DURES.—Each registered proxy advisory firm shall
11 establish, maintain, and enforce written policies and
12 procedures reasonably designed, taking into consid-
13 eration the nature of the business of such registered
14 proxy advisory firm and affiliated persons and affili-
15 ated companies thereof, to address and manage any
16 conflicts of interest that can arise from such busi-
17 ness.

18 “(2) COMMISSION AUTHORITY.—The Commis-
19 sion shall issue final rules in accordance with sub-
20 section (m) to prohibit, or require the management
21 and disclosure of, any conflicts of interest relating to
22 the offering of proxy advisor services by a registered
23 proxy advisory firm, including, without limitation,
24 conflicts of interest relating to—

1 “(A) the manner in which a registered
2 proxy advisory firm is compensated by the cli-
3 ent, or any affiliate of the client, for providing
4 proxy advisory services;

5 “(B) the provision of consulting, advisory,
6 or other services by a registered proxy advisory
7 firm, or any person associated with such reg-
8 istered proxy advisory firm, to the client;

9 “(C) business relationships, ownership in-
10 terests, or any other financial or personal inter-
11 ests between a registered proxy advisory firm,
12 or any person associated with such registered
13 proxy advisory firm, and any client, or any af-
14 filiate of such client;

15 “(D) the formulation of proxy voting poli-
16 cies, including particularly the participation of
17 large clients of the proxy advisory firm in pro-
18 viding input into that process;

19 “(E) the execution of proxy votes if such
20 votes are based upon recommendations made by
21 the proxy advisory firm in which the share-
22 holder is a proponent;

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

1 “(G) any other potential conflict of inter-
2 est, as the Commission deems necessary or ap-
3 propriate in the public interest or for the pro-
4 tection of investors.

5 “(h) RELIABILITY OF PROXY ADVISORY FIRM SERV-
6 ICES.—Each registered proxy advisory firm shall have
7 staff sufficient to produce accurate and reliable proxy vot-
8 ing recommendations. Each registered proxy advisory firm
9 shall detail procedures sufficient to permit companies re-
10 ceiving proxy advisory firm recommendations access in a
11 reasonable time to draft recommendations, with an oppor-
12 tunity to provide meaningful comment thereon, including
13 the opportunity to present details to the person(s) respon-
14 sible for developing the recommendation in person or tele-
15 phonically. Each registered proxy advisory firm shall em-
16 ploy an ombudsman to receive complaints about the accu-
17 racy of voting recommendations from the subjects of the
18 proxy advisory firm’s voting recommendations, and shall
19 resolve those complaints in a timely fashion and in any
20 event prior to voting on the matter to which the rec-
21 ommendation relates

22 “(i) DESIGNATION OF COMPLIANCE OFFICER.—Each
23 registered proxy advisory firm shall designate an indi-
24 vidual responsible for administering the policies and proce-
25 dures that are required to be established pursuant to sub-

1 sections (g) and (h), and for ensuring compliance with the
2 securities laws and the rules and regulations thereunder,
3 including those promulgated by the Commission pursuant
4 to this section.

5 “(j) PROHIBITED CONDUCT.—

6 “(1) PROHIBITED ACTS AND PRACTICES.—The
7 Commission shall issue final rules in accordance
8 with subsection (m) to prohibit any act or practice
9 relating to the offering of proxy advisor services by
10 a registered proxy advisory firm that the Commis-
11 sion determines to be unfair, coercive, or abusive, in-
12 cluding any act or practice relating to—

13 “(A) conditioning or threatening to condi-
14 tion a voting recommendation or other proxy
15 advisory firm recommendation on the purchase
16 by an issuer or an affiliate thereof of other
17 services or products, of the registered proxy ad-
18 visory firm or any person associated with such
19 registered proxy advisory firm;

20 “(B) modifying or threatening to withhold
21 a voting recommendation or otherwise departing
22 from its adopted systematic procedures and
23 methodologies in the provision of proxy advisor
24 services, based on whether an issuer, or affiliate
25 thereof, subscribes or will subscribe to other

1 services or product of the registered proxy advi-
2 sory firm or any person associated with such
3 organization.

4 “(2) RULE OF CONSTRUCTION.—Nothing in
5 paragraph (1), or in any rules or regulations adopt-
6 ed thereunder, may be construed to modify, impair,
7 or supersede the operation of any of the antitrust
8 laws (as defined in the first section of the Clayton
9 Act, except that such term includes section 5 of the
10 Federal Trade Commission Act, to the extent that
11 such section 5 applies to unfair methods of competi-
12 tion).

13 “(k) STATEMENTS OF FINANCIAL CONDITION.—
14 Each registered proxy advisory firm shall, on a confiden-
15 tial basis, furnish to the Commission, at intervals deter-
16 mined by the Commission, such financial statements, cer-
17 tified (if required by the rules or regulations of the Com-
18 mission) by an independent public accountant, and infor-
19 mation concerning its financial condition, as the Commis-
20 sion, by rule, may prescribe as necessary or appropriate
21 in the public interest or for the protection of investors.

22 “(l) ANNUAL REPORT.—Each registered proxy advi-
23 sory firm shall report annually to the Commission on the
24 number of shareholder proposals its staff reviewed in the
25 prior year, the number of recommendations made in the

1 prior year, the number of staff who reviewed and made
2 recommendations on such proposals in the prior year, and
3 the number of recommendations made in the prior year
4 where the proponent of such recommendation was a client
5 of or received services from the proxy advisory firm;

6 “(m) TRANSPARENT POLICIES.—Each registered
7 proxy advisory firm shall file with the Commission and
8 make publicly available its policy for the formulation of
9 proxy voting policies and voting recommendations;

10 “(n) RULES OF CONSTRUCTION.—

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

18 “(2) NO PRIVATE RIGHT OF ACTION.—Nothing
19 in this section may be construed as creating any pri-
20 vate right of action, and no report furnished by a
21 registered proxy advisory firm in accordance with
22 this section or section 17 shall create a private right
23 of action under section 18 or any other provision of
24 law. Provided, however, that a subject of a proxy ad-
25 visory firm voting recommendations aggrieved by a

1 proxy advisory firm's failure to comply in full with
2 subsection (h), or rules issued by the Commission
3 thereunder, may bring an action in Federal district
4 court to enforce said provisions through equitable re-
5 lief, money damages, or such other relief determined
6 by the court to be appropriate.

7 “(o) REGULATIONS.—

8 “(1) NEW PROVISIONS.—Such rules and regula-
9 tions as are required by this section or are otherwise
10 necessary to carry out this section, including the ap-
11 plication form required under subsection (a)—

12 “(A) shall be issued by the Commission in
13 final form, not later than 270 days after the
14 date of enactment of this section; and

15 “(B) shall become effective not later than
16 270 days after the date of enactment of this
17 section.

18 “(2) REVIEW OF EXISTING REGULATIONS.—Not
19 later than 270 days after the date of enactment of
20 this section, the Commission shall—

21 “(A) review its existing rules and regula-
22 tions which contemplate the existence of proxy
23 advisory firms;

24 “(B) amend or revise such rules and regu-
25 lations in accordance with the purposes of this

1 section, and issue such guidance, as the Com-
2 mission may prescribe as necessary or appro-
3 priate in the public interest or for the protec-
4 tion of investors; and

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

9 “(p) APPLICABILITY.—This section, other than sub-
10 section (o), which shall apply on the date of enactment
11 of this section, shall apply on the earlier of—

12 “(1) the date on which regulations are issued in
13 final form under subsection (o)(1); or

14 “(2) 270 days after the date of enactment of
15 this section.”.

16 **SEC. 5. COMMISSION ANNUAL REPORT.**

17 The Commission shall submit an annual report to the
18 Committee on Banking, Housing, and Urban Affairs of
19 the Senate and the Committee on Financial Services of
20 the House of Representatives that, with respect to the
21 year to which the report relates—

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

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

3 (3) specifies the views of the Commission on the
4 state of competition, transparency, internal controls,
5 integrity of ratings, and conflicts of interest among
6 registered proxy advisory firms.

7 **SEC. 6. GAO STUDY AND REPORT REGARDING REGISTERED**
8 **PROXY ADVISORY FIRMS.**

9 (a) **STUDY REQUIRED.**—The Comptroller General of
10 the United States shall conduct a study—

11 (1) to determine the impact of this Act and the
12 amendments made by this Act on—

13 (A) the quality of proxy advisory services
14 issued by registered proxy advisory firms;

15 (B) the financial markets;

16 (C) competition among proxy advisory
17 firms;

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

20 (E) the process for registering as a reg-
21 istered proxy advisory firm; and

22 (F) such other matters relevant to the im-
23 plementation of this Act and the amendments
24 made by this Act, as the Comptroller General

1 deems necessary to bring to the attention of the
2 Congress;

3 (2) to identify problems, if any, that have re-
4 sulted from the implementation of this Act and the
5 amendments made by this Act; and

6 (3) to recommend solutions, including any legis-
7 lative or regulatory solutions, to any problems iden-
8 tified under paragraphs (1) and (2).

9 (b) REPORT REQUIRED.—Not earlier than 3 years
10 nor later than 4 years after the date of enactment of this
11 Act, the Comptroller General shall submit a report on the
12 results of the study required by this section to the Com-
13 mittee on Financial Services of the House of Representa-
14 tives and the Committee on Banking, Housing, and Urban
15 Affairs of the Senate.