

# Bill Regulating Proxy Advisory Firms Approved By House of Representatives

Largely overshadowed by the recently enacted Tax Cuts and Jobs Act (see our Thoughtful Pay Alert, [Impact of New Tax Law on Executive Compensation](#) (December 21, 2017), in late December the House of Representatives approved H.R. 4015, the “Corporate Governance Reform and Transparency Act of 2017” (the “Act”), which seeks to enhance the protection of investors by regulating firms that provide proxy advisory services to institutional shareholders. On December 20, 2017, the House approved the Act by a vote of 238 to 182. The Act now moves to the Senate where it has been referred to the Committee on Banking, Housing, and Urban Affairs. Most likely, further action will be forthcoming sometime in 2018.

This Thoughtful Pay Alert summarizes the key provision of the Act. (A copy of the Act is available [here](#)).

## Background

In recent years, many in the corporate community, as well as their advisors, have expressed concern about the growing influence of the firms retained by institutional shareholders to advise them and, in some instances, even cast votes on the matters being submitted for action at each year’s Annual Meetings of Shareholders. (According to various sources, Institutional Shareholder Services, Inc. (“ISS”) and Glass Lewis & Co. LLC., the two largest firms, control approximately 97% of the proxy advisory services market.) This concern has increased since the introduction of the mandatory shareholder advisory vote on executive compensation (the so-called “Say-on-Pay” vote). In addition, potential conflict of interest concerns have been raised where these firms offer their consulting services to companies that receive (or believe they may receive) an unfavorable Say-on-Pay vote recommendation. Although these concerns have existed for some time, until the past few years there has been little action to increase transparency and accountability in this industry.

## Original Bill Introduced in 2016

In 2016, Representatives Sean Duffy (R-Wisconsin) and John Carney (D-Delaware) introduced H.R. 5311, the original ver-

sion of the Act, in the House of Representatives as a measure to promote greater accountability, transparency, responsiveness, and competition in the proxy advisory industry. Although the bill was approved by the House Financial Services Committee on June 16, 2016 (by a vote of 41-18), it advanced no further that year.

## 2017 Legislative Action

Earlier this year, the substance of the bill was included in H.R. 10, the “Financial Choice Act of 2017,” (see [Section 482](#) of the Financial Choice Act). While the Financial Choice Act was approved by the House of Representatives in June, it has since languished in the Senate. In October, Representative Duffy, joined by Representatives Lemar Smith (R-Texas) and Gregory Meeks (D-New York) re-introduced the Act as a stand-alone bill, which, earlier this month, was once again approved by the House Financial Services Committee and then by the full House of Representatives.

## Summary of Act

The Act, which would create a new regulatory framework under the Securities Exchange Act of 1934, includes the following requirements:

- **Registration requirement** – Every proxy advisory firm would be required to register with the SEC, with the information in its registration application becoming publicly available.
- **Registration statement disclosure** – The registration process would require each firm to describe, among other things:
  - ▶ its procedures and methodologies for developing proxy voting recommendations (including whether and how company size influences voting recommendations);
  - ▶ its code of ethics (if any);
  - ▶ any potential or actual conflict of interest arising from its business model and its largest client relationships; and
  - ▶ its policies and procedures for managing conflicts of interest.

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- **SEC must affirmatively approve registration** – The SEC would be required to take affirmative action to grant an application for registration, which may be denied if it finds that a firm “has failed to satisfy to the Commission’s satisfaction that it is able to consistently produce proxy advice based on accurate information and to materially comply with [its own] procedures and methodologies...”
- **Conflicts of Interest** – The SEC would be required to promulgate rules addressing the management and disclosure of any conflicts of interest by a registered firm, including conflicts relating to how the firm is compensated for providing proxy advisory services and its provision of consulting, advisory, or other services.
- **Voting recommendation reliability** – Each registered firm would be required to:
  - Employ sufficient staff to produce proxy voting recommendations that are based on accurate and current information;
  - Implement procedures allowing companies sufficient time to receive and respond to voting recommendations before they are finalized and transmitted to clients; and
  - Employ an ombudsman to receive and seek to resolve complaints about the accuracy of voting information used in making recommendations in a timely manner.
- **Prohibited conduct** – The SEC would be required to promulgate rules prohibiting unfair, coercive, or abusive acts or practices relating to the offering of services by a registered proxy advisory firm, including conditioning voting recommendations on the purchase of other services or products from the firm or any person associated with the firm.
- **Financial condition** – Each registered proxy advisory firm would be required to furnish the SEC certified financial statements and other information on its financial condition at intervals established by the SEC.
- **Annual report** – Each registered proxy advisory firm would be required to annually report to the SEC, among other things, the number of shareholder proposals reviewed in the prior year, the number of recommendations made in the prior year, and the number of recommendations made in the prior year where the proponent was a client of or received services from the firm.

ing, and Urban Affairs for consideration. Its prospects – either as part of the Financial Choice Act or as a stand-alone measure – will depend on the support the Act can generate in the Senate. Just as when it was originally introduced in 2016, the Act has received support from several major organizations, including the U.S. Chamber of Commerce, the National Investor Relations Institute, the Business Roundtable, and the Center on Executive Compensation. Consequently, it bears watching this year.

### Need Assistance?

Compensia has significant experience in helping companies understand and address the corporate governance and executive compensation policies of the major proxy advisory firms. If you have any questions on the topics covered in this Thoughtful Pay Alert or would like assistance in assessing how these policies are likely to affect your executive compensation program, please feel free to contact us. ■

### Next Steps

As noted above, the Act was approved by the House of Representatives on December 20, 2017. It has now moved to the Senate where it has been referred to the Committee on Banking, Hous-

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## Bill Regulating Proxy Advisory Firms Approved By House of Representatives (continued)

### About Compensia

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