CANADIAN COUNCIL of CHIEF EXECUTIVES
CONSEIL CANADIEN des CHEFS D'ENTREPRISE

The Honourable / L'honorable
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President and Chief Executive Officer
Président et chef de la direction

July 22, 2014

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
The Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

c/o Me Anne-Marie Beaudoin
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The Secretary
Ontario Securities Commission
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RE: Canadian Securities Administrators Proposed National Policy 25-201
Guidance for Proxy Advisory Firms

On behalf of the 150 member chief executives of the Canadian Council of Chief Executives, I am pleased to submit our comments in response the CSA's proposal for a guidance document governing the conduct of proxy advisory firms (PAFs).

By way of introduction, we acknowledge the growing role and importance of PAFs in the smooth functioning of capital markets. In an increasingly complex world of corporate transactions, they can and do provide a useful function in sorting and assessing information that is relevant to shareholders and investment advisors.

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But with that role also comes important responsibilities, given the growing reliance on PAFs by many institutional investors and thus their potential impact on the market. These responsibilities particularly relate to their need to provide objective, well-researched and independent advice to their clients. Since PAFs routinely emphasize the disclosure obligations of issuers and seek to foster high levels of transparency, they should not be surprised to be asked to live by similar standards.

It also is important to acknowledge that PAFs exist because of a demand for their services by institutional investors, mutual funds, investment advisors and other market participants, and that these services are delivered through private, contractual arrangements. As well, the responsibility for sound and accurate assessment of corporate governance practices does not rest solely with PAFs. It is worth noting that the US Securities and Exchange Commission's recently released *Staff Legal Bulletin No. 20*, while it deals with important issues related to PAFs, is in fact primarily addressed to investment advisors with respect to their responsibilities in voting client proxies. The SEC document makes clear that investment advisors have a fiduciary duty to carefully examine and assess the basis upon which any PAF makes a vote recommendation. It is not enough to simply accept the recommendation at face value.

The CSA's 2012 consultation paper drew submissions from a number of interested parties, including CCCE members, and the renewed focus on the practices of PAFs has recently led to a better dialogue among key players in the debate. Nonetheless, consultation with our member companies has revealed a significant level of concern with respect to a number of current practices among PAFs, and considerable doubts about the effectiveness of the CSA's proposed approach.

We appreciate that securities agencies may be constrained by current legislative authority and institutional capacities from undertaking a more prescriptive approach, and we see the current proposal as a first step in what likely will be a multi-step process. We would urge that the policy adopted be as robust as possible given current regulatory authority, and we outline below some thoughts on how this might work. We also believe that CSA should commit to a thorough review of the policy, within 24 months, with a view to determining its effectiveness. This review should involve consultation with issuers, institutional

investors and other interested parties, and also examine further steps to ensure PAFs are adhering to best practices of transparency and professionalism.

Recognizing the proposed policy as a first step, we agree with the focus on three areas: 1) the obligation upon PAFs to avoid conflicts of interest, real or perceived; 2) the need to ensure the transparency and accuracy of vote recommendations prepared by PAFs; and 3) the need for PAFs to be open and consultative about how they develop and update their proxy voting guidelines.

Conflicts of Interest

Effectively dealing with potential conflicts of interest goes to the very heart of the role of PAFs and their ability to offer independent advice. The proposed policy adequately describes situations in which a conflict of interest may exist. As well, it outlines a number of important steps that PAFs should implement, including written policies to identify, manage and mitigate potential conflicts; internal safeguards and controls to monitor the effectiveness of their policies; and a code of conduct governing the firm and its staff.

The recently released SEC policy provides useful guidance in this area. Specifically, it suggests that PAFs must determine whether they have a "significant" relationship with the company that is the subject of the advice, and if so, the PAF must disclose such significant relationship or material interest to any recipient of its advice. In undertaking such disclosure the SEC cautions that the use of "boilerplate language that such a relationship or interest may or may not exist" is insufficient. As well, the paper suggests that such disclosure by a PAF must be sufficiently detailed to allow the client to assess the vote recommendation's reliability and objectivity.

Transparency and Accuracy of Vote Recommendations

Much of the recent concern with respect to PAFs can be traced to instances where an issuer disagreed with the vote recommendation issued by a PAF, and often related to a question of the information or assessment upon which the recommendation was based. These concerns can be exacerbated by an unwillingness to engage with the issuer and/or discuss the basis for the recommendation. While legitimate differences of opinion will always exist, it

is incumbent upon PAFs to ensure that they have a solid factual and analytical basis for any specific recommendation.

A related concern is whether PAFs have the internal resources and staff training to undertake analysis of potentially complex corporate transactions. As the recent SEC paper points out, it is the responsibility of institutional investors, and others who rely on a PAF's advice, to satisfy themselves that the PAFs they retain have the capacity and competency to adequately analyze relevant proxy issues.

Proxy Voting Guidelines

While proxy voting guidelines have their value, a too-rigid approach can lead to a "check-the-box" governance approach that fails to take account of specific corporate circumstances. Our members are concerned that PAF requirements can too easily become de facto corporate governance standards, without adequate consideration and discussion with affected stakeholders. As well, there have been instances where a PAF has chosen to change their proxy voting guidelines without adequate notice or consultation, leading to an adverse vote recommendation that was arguably unfair to the issuer.

Our Recommended Approach: *Comply or Explain*

Our key recommendation is that CSA consider the implementation of a 'comply or explain' approach with respect to certain key responsibilities of PAFs. *Comply or explain* has been used successfully by securities regulators in Canada to deal with a number of important corporate governance practices. Such an approach can be an effective and streamlined alternative to more burdensome regulation. *Comply or explain* sets broadly acceptable policies or standards while allowing the party in question to justify why it has chosen a somewhat different path.

Were this approach to be adopted, we would see at a minimum that PAFs should devise practices in the following areas, or explain why they have chosen not to:

Conflicts of interest. PAFs should adopt and publish their policies and procedures related to the identification and mitigation of conflicts, implement internal safeguards and controls, develop a code of conduct for

all staff, and periodically evaluate the effectiveness of their policies and safeguards. While we believe that as a matter of principle a PAF should avoid making a vote recommendation where a conflict exists, should they choose to do so, they must be able to demonstrate the steps they have taken to ensure that the recommendation is independent and objective.

Dialogue with companies that are the subject of a vote recommendation. We are concerned about the unwillingness of some PAFs to effectively engage with issuers who are not clients. The proposed CSA policy suggests that, where applicable, a PAF should disclose the nature and outcome of any discussion or contact with an in issuer in the preparation of a vote recommendation. We would go further and suggest that at a minimum PAFs should have a policy of communication with firms about which they intend to issue a vote recommendation, or explain why they reject such a practice. This responsibility is heightened where it is a recommendation that is adverse to the company. The policy could also include the requirement for the PAF to acknowledge that the company disagrees with the information or analysis upon which the recommendation is based.

Internal capacity and training. Credible and reliable voting recommendations require that PAFs have sufficient internal resources and adequately trained staff to do the necessary research and analysis. We would encourage the proxy advisory industry to develop and disclose their training standards, their ongoing programs for capacity building, and their quality assurance programs.

Proxy voting guidelines. PAFs should publish their proxy voting guidelines and any updates to them and clearly describe the rationale for such guidelines. They also should make available to market participants a clear description of how they develop and update their guidelines. Proposed changes to the guidelines should be widely communicated to the issuer and investor community and sufficiently in advance of the upcoming proxy season. And finally, PAFs should regularly consult with clients, issuers and other market participants on evolving corporate governance practices and how they could affect their voting guidelines.

The current proposal and future activities of Canadian securities regulators in this area also have to be seen in a wider international context. The capital market regime is increasingly cross-border in nature, given that many of Canada's biggest issuers are cross-listed in both the United States and Canada. We referred above to the SEC's recent initiative in this area through *Staff Legal Bulletin No. 20*. As PAFs adopt best practices to meet ongoing SEC requirements, it is essential that Canadian policy developments align and keep pace in order to ensure enhanced levels of protection on both sides of the border. The SEC policy is a significant development and the Canadian response should not detract from it.

In closing, we commend CSA for taking this next step in addressing the role that proxy advisory firms play in Canadian capital markets. We look forward to further developments that can serve the interests of Canadian companies and their shareholders.

Sincerely,