HANSELL

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VIA EMAIL

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

Me Anne-Marie Beaudoin
Corporate Secretary
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800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, Ontario M5H 3S8

Dear Sirs/Madams:

Proposed National Policy 25-201 Guidance for Proxy Advisory Firms

We appreciate the opportunity to comment on the Canadian Securities Administrators' ("CSA") proposed National Policy 25-201 *Guidance for Proxy Advisory Firms* (the "Proposed Policy").

Hansell LLP provides expert, independent legal and governance counsel to both shareholders and boards of directors. We advise both issuers and investors and deal regularly with the policies and recommendations of proxy advisory firms in a variety of contexts.

The CSA has clearly devoted a great deal of time and thought to the proxy advisory issue. We note that regulatory resources are finite. In our view, issuers and investors would derive greater benefit from regulatory focus on the mechanics of the proxy voting system. We urge the CSA to focus its efforts on reviewing the proxy voting infrastructure to ensure that voting entitlements are properly reconciled and votes are accurately counted at the meeting.[1]

We have set out our responses and suggested improvements to the Proposed Policy under the following headings: issues and appropriate response; conflicts of interest; dialogue between proxy advisory firms and issuers; and automatic vote services.

1. Issues and Appropriate Response

In order to provide some context to our response, it is important to note that proxy advisory firms provide services and vote recommendations to their clients pursuant to private contractual agreements. Those clients, generally institutional investors, have not expressed concerns publicly with the quality of the services they receive and are not seeking the intervention of the CSA. Proxy advisory firms are not market participants and members of the CSA accordingly have no authority to regulate them in any event.

Issuers have consistently expressed concerns about the impact of proxy advisory firms on the outcome of shareholder votes. Accordingly, a regulatory response is appropriate in this context to reinforce confidence in the capital markets. This response, however, must be calibrated to the nature of a demonstrable problem. Issuers express concern with the degree of influence exerted by proxy advisors, but there is still no clear evidence of that influence. Investors who have engaged in the public debate over the role of proxy advisory firms state that they exercise their own judgement in casting their votes, even if they subscribe to the services of a proxy advisory firm. We do understand that some investors adopt and follow the guidelines of the proxy advisory firms. It is not clear how often those investors adopt the recommendations of the proxy advisors because they agree with them, because they don't have sufficient shares to warrant spending more time analyzing the issues, or because they are indifferent to the issue. It is at least clear that there is no compelling evidence that proxy advisors determine the outcome of shareholder votes. It is as likely in many cases that the proxy advisors recommendations align with the views of their clients and that is the reason that many of the votes follow those recommendations.

Issuers are also concerned with the errors made by the proxy advisors. We have addressed this concern in more detail in our comments below. In addition, some are concerned that proxy advisory firms have become *de facto* corporate governance standard setters. The evidence suggests that proxy voting guidelines are largely developed through market engagement and incorporate generally accepted investor expectations for appropriate corporate governance that respond to the interests and concerns of institutional investors.

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[1] See our comment letter on the CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure* from November 13, 2013, available at <http://hanselladvisory.com/includes/CSA_Commentary.pdf>.

We agree that any action taken by the CSA with respect to the activities of proxy advisor firms should be limited to providing guidance on best practices that will promote transparency and foster understanding among market participants about the activities of those firms. The Proposed Policy allows flexibility and strikes the proper balance between the concerns of issuers to understand the role of proxy advisory firms and the interests of shareholders using the services of proxy advisory firms. Such transparency, dialogue and understanding will contribute to preserving the integrity of the proxy voting process, which will promote confidence in our capital markets.

We also agree that the approach taken by the CSA is consistent with the recommendations arising from other international initiatives and can be implemented by proxy advisory firms operating in other jurisdictions. We note in particular that the Proposed Policy corresponds with the recent regulatory approaches taken in the US and Europe. On June 30, 2014, staff of the US Securities and Exchange Commission issued guidance (in the form of 13 Q&As) concerning the proxy voting responsibilities of investment advisors, the use of proxy advisory firms and the applicability of proxy solicitation rules to such firms (the "SEC Staff Guidance").[2] The March 2014 publication of the Best Practice Principles for Governance Research Providers Group[3] formed as a result of the recommendations from the European Securities and Markets Authority (the "EU Best Practice Principles") also follows this non-prescriptive regulatory approach.

In light of this increased attention by regulators, we agree with other commenters who have acknowledged that proxy advisory firms have considered the concerns raised and are reviewing their practices, including managing potential conflicts of interests and adopting practices to promote more responsible use of proxy voting advice through increased transparency and disclosure. We believe the Proposed Policy endorses many of the best practices adopted in the marketplace and represents a step in the right direction towards addressing the concerns raised by market participants. In response to concerns that the Proposed Policy may not compel proxy advisory firms to follow the proposed best practices, we suggest that the CSA monitor market developments and seek feedback from market participants within a reasonable period of time after the Proposed Policy is implemented to determine whether any further regulatory action is necessary.

2. Conflicts of interest

The Proposed Policy identifies examples of circumstances where an actual or potential conflict of interest may exist. These circumstances include: (i) where a proxy advisory firm provides vote recommendations to an investor client on corporate governance matters of an issuer to which the proxy advisor provided consulting services; (ii) where an investor client of the proxy advisory

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2 Securities and Exchange Commission Staff Legal Bulletin No. 20 (IM/CF) (June 30, 2014), available at <http://www.sec.gov/interps/legal/cfslb20.htm>.

3 The Best Practice Principles for Governance Providers Group, *Best Practice Principles for Providers of Shareholding Voting Research & Analysis* (March 2014), available at <http://bppgrp.info/wp-content/uploads/2014/03/BPP-ShareholderVoting-Research-2014.pdf>.

firm submits a shareholder proposal that could be the subject of a favourable vote recommendation by the proxy advisor; and (iii) where a proxy advisory firm is owned by an investor client who invests in issuers in which the proxy advisory firm makes vote recommendations. We agree with the statement in the Proposed Policy that effective management and mitigation of these conflicts fosters independent and objective proxy advisory services to a client.

The Proposed Policy includes examples of practices that proxy advisory firms may consider to address actual or potential conflicts of interests. To achieve the intent of the Proposed Policy, we believe as a minimum standard that proxy advisory firms should adopt a code of conduct that sets standards of behaviour and practices of the organization and expectations for individuals acting on its behalf. Annual affirmation of compliance from all individuals acting on behalf of the proxy advisory firm and regularly reviewing the effectiveness of the code should also be expected as a minimum standard. We believe adopting a code of conduct demonstrates the organization's commitment to offering independent and objective services, fosters understanding across the organization and sets a tone of compliance at the top of the organization. To achieve the purpose of the Proposed Policy, the code of conduct, along with a description of other policies and practices to address conflicts of interest, should be disclosed and made available on the proxy advisory firm's website.

To minimize concerns about conflicts of interest and to maintain the independence of voting recommendations, we agree that proxy advisory firms are also expected to disclose any actual or potential conflict of interest. We also agree that the use of boilerplate language is insufficient and expect, as set out in the Proposed Policy, that the disclosure be specific and provide sufficient information to enable the client to understand the nature and substance of the conflict. We suggest revising the proposed language in paragraph 2.1(6) of the Proposed Policy to clarify that the nature of relationship or interest and the steps taken by the proxy advisory firm to mitigate the conflict should also be disclosed. This expectation is included in the SEC Staff Guidance.[4] Any disclosure must also be accessible and prominent – we suggest further revising the Proposed Policy to clarify that any actual or potential conflict of interest should be disclosed in the vote recommendation report (or provided another accessible way in connection with the report) to allow the client the opportunity to assess the reliability or objectivity of the voting recommendation. By way of example, the SEC Staff Guidance notes that the disclosure of conflicts "may be made publicly or between only the proxy advisory firm and the client."[5]

The Proposed Policy also encourages proxy advisory firms to consider designating a person to assist with monitoring compliance and assessing the appropriateness of the internal safeguards and controls to address conflicts of interest. We agree in principle with this concept and note that

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4 The SEC Staff Guidance states that, in that context, the disclosure should "enable the recipient to understand the nature and scope of the relationship or interest, including the steps taken, if any, to mitigate the conflict, and provide sufficient information to allow the recipient to make an assessment about the reliability or objectivity of the recommendation."

5 SEC Staff Guidance, *supra* note 2, Q&A ##11-13.

it is important for the compliance function (or the person responsible for compliance) has a role, authority and reporting relationship that is clearly defined. The best practice is for a compliance officer to have a direct reporting authority to the CEO and the board of directors (or equivalent body) so that the flow of information regarding compliance is not filtered or supressed before reaching the authority expected to be responsible for setting and preserving the culture of compliance. In order to properly monitor and assess compliance with conflicts of interest controls, we believe that the compliance function should be independent of the proxy advisory firm's research and advisory services. The compliance function should therefore not assist with addressing determination of vote recommendations, development of proxy voting guidelines and communication matters. We note that a similar protocol exists in National Instrument 25-101 *Designated Rating Organizations* ("NI 25-101"). While NI 25-101 deals with credit rating organizations, the policy rationale regarding the compliance officer's independent function is instructive.[6] The compliance officer should be free to perform their duties objectively and without consideration to the company's operational functions and business prospects.

3. Dialogue between proxy advisory firms and issuers

We recognize that proxy advisors play a meaningful role in proxy voting process by assisting institutional investors in exercising their voting rights at shareholder meetings. Institutional investors use their reports as a resource in formulating their voting decisions. Smaller institutional investors who lack the internal resources to review several sources of research and analysis may rely heavily on the voting recommendations of proxy advisors. Retail investors may also be influenced by the voting recommendations that are subsequently published in the media. Further, a proxy advisory firm's voting recommendations can shift momentum for or against management or dissident shareholders in the context of contested meetings. As a matter of integrity and confidence in the capital markets, vote recommendation reports must be informed and contain accurate information.

Corporate governance cannot be properly evaluated without in-depth knowledge and understanding of the issuer, its board and management and the environment in which it operates. One opportunity for dialogue between proxy advisory firms and issuers occurs outside the proxy solicitation period while proxy advisory firms conduct research and engage with stakeholders to develop policy and voting guidelines. Such dialogue should be expected as a minimum standard as it provides context and clarification to matters of relevance to proxy advisory firms and on unique governance characteristics of certain issuers, which can improve proxy voting advice. We have taken note of the complaints from issuers and their advisors that companies are facing increasing pressure from proxy advisory firms to conform their governance practices to the "best" practice benchmarks established by those firms. In response, we believe that increased dialogue and engagement with issuers during the consultation phase will help issuers understand the proxy advisory firm's governance benchmarks and how these benchmarks are developed. We

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6 In particular, subsection 12(4) of NI 25-101 provides that a compliance officer must not, while serving in such capacity, participate in the development of credit ratings, methodologies or models.

therefore support the CSA's statement reminding issuers to engage constructively with their shareholders in respect of their corporate governance practices and proxy voting matters.

Executive compensation is an example of an approach that benefits from this type of dialogue. The board of directors (with the compensation committee) is responsible for determining compensation programs for executive officers that reflect the issuer's compensation philosophy and risk profile. Structuring long-term compensation plans that address individual motivational needs and company specific performance metrics is a complex process. As such, crafting a compensation package that conforms to a general standard or "best practice" on executive compensation may not be in the best interests of the issuer.[7] Increased dialogue with proxy advisory firms and investors and disclosure of the relevant factors that informed the executive compensation plan in the issuer's information circular can prevent the application of a "one-size fits all" voting guideline and lead to more informed proxy voting advice.

In respect of the preparation to vote recommendation reports for specific issuers, we would not suggest a minimum standard and agree with the guidance in the Proposed Policy allowing proxy advisory firms determine how they wish to engage with issuers in preparing vote recommendations. We believe that any engagement procedure during the vote recommendation process should balance the risk of undue influence by issuers lobbying for favourable recommendations, the additional costs imposed on proxy advisory firms, and the importance of disclosing accurate information for the integrity of the capital markets. If the proxy advisory firms has engaged with the issuer, we believe that they should disclose the nature and outcome of any dialogue or contact with an issuer in the preparation of the vote recommendations. A similar disclosure expectation is outlined in the EU Best Practice Principles.[8] We would also expect that proxy advisory firms identify the sources of any factual information contained in the report that is not contained in the issuer's public filings.

To manage the risk that a vote recommendation report may contain inaccurate issuer data, we believe there must be a process to correct the error before the report is disseminated to investors. One way to prevent factual errors or omissions in a proxy advisory firm's vote recommendation report is to encourage proxy advisors to provide issuers with an opportunity to review the draft report. We understand that Institutional Shareholder Services ("ISS") generally provides draft proxy analyses to companies in the S&P/TSX Composite Index for a fact checking review. This practice demonstrates that ISS recognizes the value in providing issuers with an opportunity to review draft proxy analyses. ISS does not, however, allow issuers to review drafts of any controversial or contentious agenda items covered by its reports. We believe that factual

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7 To illustrate this concern, we note that a 2012 study conducted in the U.S. found that 54.9% of respondents were influenced by the proxy advisory firms' public policies and vote recommendations on executive compensation. See *The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions*, David F. Larcker, Allan L. McCall and Brian Tayan, *The Conference Board: Director Notes* (March 2012).

8 EU Best Practice Principles, *supra* note 3, at p. 18.

inaccuracies in proxy reports is most detrimental at meetings where there is a vote on a contentious issue. For example, the choice between a dissident's slate of directors and the incumbent directors has an enormous impact on the direction of the company. It is therefore imperative that the vote recommendations in these context not contain errors or inaccurate information.

Given that the integrity of the capital markets rests on providing investors with accurate information, we would expect that proxy advisory firms make a draft report available to issuers (and dissidents, where dissidents have prepared and mailed a circular to all shareholders) in advance of issuing the final report for the purpose of verifying the facts underlying the vote recommendation and correcting any substantive factual inaccuracies. We note that a similar "fact checking" procedure is already recommended in France.[9] As stated above, we agree with the CSA's expectation that proxy advisory firms publish on their website their policies and procedures regarding communications with issuers, which would include disclosing their policies on submitting draft reports for review.

4. Automatic vote services

The ability to vote is a fundamental part of a shareholder's ownership rights. Shareholder voting is an important way for shareholders to impact corporate governance, communicate preferences and signal confidence or lack of confidence in management. Our institutional investor clients devote considerable resources to engaging with boards, management and other stakeholders, reviewing information circulars and other continuous disclosure documents and voting their shares on an informed basis.

The introduction of majority voting for all TSX-listed issuers, in addition to the increasing number of shareholder proposals and governance matters put forward at a meeting of shareholders, including those with respect to special transactions and executive compensation, has resulted in large volumes of materials for investors to review. Smaller institutional investors may not have the resources to review and analyze several sources of proxy related material for every matter put forward to a vote at a shareholder meeting. These investors may therefore rely on a proxy advisory firm's automatic vote execution services based on the proxy advisory firm's proxy voting guidelines or a customized voting policy designed by the investor.

Although these services are a cost-effective way for investors to exercise their voting rights, an overreliance on a proxy advisor's vote recommendations has been identified as an area of concern. While we understand this concern, we do not accept the proposition from some commenters that some investors have blindly outsourced their voting discretion to proxy advisory firms. Institutional investors, such as pension funds, mutual funds and insurance companies, have stewardship responsibilities to their clients and beneficiaries and therefore have the ultimate responsibility for voting in the best interests of their clients. As such, we do not

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[9] Autorité des Marchés Financiers, AMF *Recommendation No. 2011-06 on Proxy Voting Advisory Firms* (March 18, 2011).

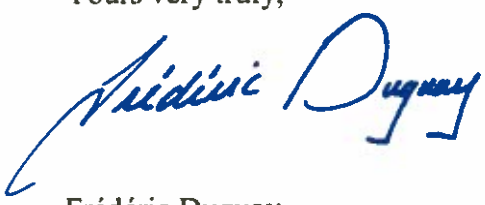
agree with the suggestion that automatic voting services be eliminated, confined to routine matters, or exclude issues where the proxy advisory firm issues a negative recommendation.

The SEC Staff Guidance outlines SEC Staff's view on this topic. In particular, SEC Staff confirm that investment advisers (such as fund managers) have an ongoing responsibility to "adopt and implement policies and procedures that are reasonably designed to provide sufficient ongoing oversight" and ensure that proxy votes are cast in accordance with their client's best interests. The SEC Staff Guidance provides examples of such policies and procedures, including measures requiring the proxy advisory firm to provide to the investment adviser updates about business changes that affect the proxy advisory firm's "capacity and competency to provide proxy voting advice," as well as changes in its conflict policies and procedures. [10]

In the Canadian context, to discourage rote outsourcing of voting discretion to proxy advisory firms, we agree with a policy, as suggested in the CSA Notice, that encourages proxy advisory firms to obtain confirmation that the client has reviewed and agreed with the proxy advisory firm's proxy voting guidelines. We believe this type policy can promote active responsible voting and ensure that investors' views are in alignment with the proxy advisory firm's proxy voting guidelines. Whether proxy advisory firms should obtain such confirmation annually and/or following any amendments to the proxy voting guidelines should be determined by the client on a case-by-case basis. For example, to the extent that institutional investors have developed their own customised proxy voting guidelines, which are implemented by the proxy advisory firm, such a confirmation would not be necessary.

Thank you for this opportunity to comment on the Proposed Policy. If you would like to discuss this comment letter in further detail, please contact any of us.

Yours very truly,



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10 SEC Staff Guidance, *supra* note 2, Q&A ##3-4.