

CSA Notice 25-301

Update on CSA Consultation Paper 25-401 *Potential Regulation of Proxy Advisory Firms*

September 19, 2013

Introduction

On June 21, 2012, the Canadian Securities Administrators (CSA) published for comment Consultation Paper 25-401 *Potential Regulation of Proxy Advisory Firms* (the **Consultation Paper**).

The purpose of the consultation was to provide a forum for discussion of certain concerns raised about the services provided by proxy advisory firms and the potential impact on Canadian capital markets and to determine if, and how, these concerns should be addressed by the CSA.

This notice provides an update to market participants on the status of the consultation.

Background

In the Canadian context, limited information was available about the ways in which institutional investors use the services of proxy advisory firms and the extent of reliance on their services. Whether institutional investors shared any of the concerns raised was also unclear.

We sought additional information and views to determine whether we need to address the following concerns identified in the Consultation Paper:

- potential conflicts of interest;
- perceived lack of transparency;
- potential inaccuracies and limited dialogue between proxy advisory firms and issuers;
- potential corporate governance implications; and
- the extent of reliance by institutional investors on the recommendations provided by proxy advisory firms.

The Consultation Paper outlined possible CSA responses and requested feedback.

Summary of Comments

The comment period ended on September 21, 2012. We received 62 comment letters from various market participants, including issuers, institutional investors, industry associations, proxy advisory firms and law firms. We have reviewed the comments and wish to thank all of the commenters for contributing to the consultation.

The comments differed between the respective market participant groups. The following is a brief summary of the comments received:

- While issuers generally acknowledged the important role of proxy advisory firms, they seemed concerned about their influence on the voting decisions of institutional investors. Most issuers agreed with each of the concerns identified in the Consultation Paper. Issuer associations and law firms generally share the views of issuers.
- Institutional investors noted that proxy advisory firms provide them with useful and cost effective services when exercising their voting rights. They subscribe to the research reports prepared by proxy advisory firms to inform their voting decisions which are based on their own assessment of the proposals and their proxy voting guidelines. They indicated that they do not necessarily follow the vote recommendations of proxy advisory firms. Institutional investors are generally satisfied with the services provided by proxy advisory firms. Associations representing institutional investors generally expressed the same views.
- Commenters generally agreed that the business model or the ownership structure of proxy advisory firms may lead to conflicts of interest. A majority of issuers believed that conflicts of interest exist within proxy advisory firms and that they are not appropriately mitigated. On the other hand, a majority of institutional investors acknowledged the potential of conflicts of interest but took the position that they are properly identified, managed and disclosed.
- Issuers questioned the quality of vote recommendations and concluded that additional transparency and disclosure of underlying methodologies and analyses would benefit market participants. Institutional investors did not believe that the information would be beneficial to the market. They argued against requiring disclosure of proprietary analytical models.
- Issuers were concerned with potential inaccuracies in research reports and limited dialogue between the proxy advisory firms and the issuers. A majority of institutional investors were of the view that the dialogue processes in place suffice to avoid factual errors. Some institutional investors believed that, in reality, perceived inaccuracies are mere differences of opinion or analysis.
- Commenters agreed that it is important for proxy advisory firms to consult with market participants when developing and updating voting guidelines. They also agreed on the importance of disclosing such guidelines publicly. There was no consensus among commenters about the extent of dialogue necessary between proxy advisory firms and market participants.
- The views on the appropriate CSA response diverged. Some commenters suggested that a set of recommended best practices is sufficient while others were of the view that a rule-based approach, including registration of proxy advisory firms as advisers, is necessary. Some institutional investors suggested that a CSA response was not warranted.

- Proxy advisory firms indicated that they have appropriate policies and procedures in place to address the concerns identified in the Consultation Paper. They noted that they are committed to provide objective and accurate services to their clients and have recently demonstrated a willingness to respond to concerns by voluntarily making changes to some of their processes. Proxy advisory firms do not believe that their activities should be regulated.

Next Steps

After an extensive review of the comments received, our conclusion is that a CSA response is warranted. In our view, a policy-based approach that would give guidance on recommended practices and disclosure for proxy advisory firms will promote transparency and understanding in the services provided and is an appropriate response under the circumstances.

We are in the process of developing our proposed approach, which we intend to publish for comment in the first quarter of 2014.

Questions

Please refer your questions to any of the following:

Autorité des marchés financiers
Michel Bourque
Senior Policy Advisor
514-395-0337 ext.4466
1-877-525-0337
michel.bourque@lautorite.qc.ca

Autorité des marchés financiers
Marie-Josée Normand-Heisler
Senior Policy Advisor
514-395-0337 ext.4464
1-877-525-0337
marie-josée.normand-heisler@lautorite.qc.ca

Ontario Securities Commission
Naizam Kanji
Deputy Director, Mergers &
Acquisitions, Corporate Finance
416-593-8060 1-877-785-1555
nkanji@osc.gov.on.ca

Ontario Securities Commission
Frédéric Duguay
Senior Legal Counsel, Corporate Finance
416-593-3677 1-877-785-1555
fduguay@osc.gov.on.ca

Alberta Securities Commission
Sophia Mapara
Legal Counsel
403-297-2520 1-877-355-0585
sophia.mapara@asc.ca