

CSA Notice and Request for Comment
Proposed National Policy 25-201
Guidance for Proxy Advisory Firms

April 24, 2014

Introduction

The Canadian Securities Administrators (CSA or we) are publishing for a 60-day comment period proposed National Policy 25-201 *Guidance for Proxy Advisory Firms* (the Proposed Policy).

The text of the Proposed Policy is contained in Annex A of this notice and will also be available on websites of CSA jurisdictions, including:

www.lautorite.qc.ca
www.albertasecurities.com
www.bsc.bc.ca
www.gov.ns.ca/nssc
www.nbsc-cvmnb.ca
www.osc.gov.on.ca
www.fcaa.sk.ca
www.msc.gov.mb.ca

Substance and purpose

Institutional investors are increasingly engaged in advancing good corporate governance in companies, and one of the ways by which they do so is the exercise of their voting rights. Issuers also rely on proxy voting to approve corporate governance matters or certain transactions. Accordingly, proxy voting is an important feature of our capital markets. We note that proxy advisory firms play an important role in the voting process by assisting institutional investors in exercising their voting rights at shareholders' meetings. Institutional investors, in making their voting decisions, may use the services of proxy advisory firms in different ways and to varying degrees. Some proxy advisory firms also provide services to issuers, including consulting services on corporate governance matters. In Canada, the proxy advisory industry is dominated by two firms - Institutional Shareholder Services Inc. and Glass, Lewis & Co.

A number of factors are contributing to the growing demand for the services offered by proxy advisory firms, including enhanced continuous disclosure requirements, the

number and complexity of matters to be voted upon by shareholders and the time constraints imposed by the concentrated proxy season in Canada.

In recent years, certain market participants, including issuers, issuer associations and law firms, have raised concerns about the services provided by proxy advisory firms. There is general agreement amongst all market participants of the potential for conflicts of interest which may compromise the independence of services provided by proxy advisory firms. There are also concerns raised by issuers, issuer associations and law firms about the manner in which vote recommendations and proxy voting guidelines, which may have an influence on the voting decisions of institutional investors and the corporate governance practices of issuers, are developed. However, the extent of the actual influence of proxy advisory firms on market behaviour is subject to debate.

The Consultation Paper (as defined below), along with other international initiatives, brought a renewed focus on the activities of proxy advisory firms, with the result that proxy advisory firms are reviewing, and engaging in dialogue with market participants about, their practices to address the concerns raised by market participants.

Based on the comments received and our analysis of the concerns raised, we are of the view that a CSA response is warranted. In our view, there are several areas, and in particular, those relating to conflicts of interest, transparency and accuracy, where a policy-based approach providing guidance on recommended practices and disclosure will (i) promote transparency in the processes leading to a vote recommendation and the development of proxy voting guidelines; and (ii) foster understanding among market participants about the activities of proxy advisory firms.

Although the Proposed Policy applies to all proxy advisory firms, the guidance is not intended to be prescriptive. Instead, we encourage proxy advisory firms to consider this guidance in developing and implementing their own practices. We also remind proxy advisory firms that this guidance is not intended to be exhaustive and that it does not detract proxy advisory firms from their responsibility to comply with applicable securities law. The Proposed Policy will provide institutional investors or other proxy advisory firms' clients as the legitimate judges with a framework for evaluating the services provided to them by proxy advisory firms.

Background

On June 21, 2012, the 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.

We sought additional information and views to determine whether we needed 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.

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. The comments differed among the respective market participant groups.

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 shared the issuers' view.

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, they explained, are based on their own assessment of the proposals and their proxy voting guidelines and 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.

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 providing objective and accurate services to their clients and have

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.

The Consultation Paper, along with other international initiatives, brought a renewed focus on the activities of proxy advisory firms. These initiatives include:

- The U.S. Securities and Exchange Commission (the SEC) published for comment on July 14, 2010 its Concept Release on the U.S. Proxy System which included a discussion on the concerns raised by market participants about proxy advisory firms. On December 5, 2013, the SEC held the Proxy Advisory Services Roundtable to discuss these concerns;
- The New York Stock Exchange Commission on Corporate Governance carried out a comprehensive review of corporate governance principles and published a report dated September 23, 2010 which sets out recommendations regarding proxy advisory firms;
- The French Autorité des marchés financiers (AMF France) issued *AMF Recommendation No. 2011-06 of 18 March, 2011 on Proxy Advisory Firms*. AMF France recommended standards for proxy advisory firms in order to promote transparency and manage conflicts of interest;
- The European Commission published for comment on April 5, 2011, the *Green Paper: The EU Corporate Governance Framework*, aimed at assessing the need for improvement of corporate governance in European listed companies. On April 9, 2014, the European Commission published Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, which includes proposed amendments designed to enhance the transparency of proxy advisory firms;
- The European Securities and Markets Authority (ESMA) published for comment on March 22, 2012 the *Discussion Paper: An Overview of the Proxy Advisory Industry. Considerations on Possible Policy Options*. ESMA published its *Final Report: Feedback Statement on the Consultation regarding the Role of the Proxy Advisory Industry* on February 19, 2013 and encouraged the proxy advisory industry to develop its own Code of Conduct; and
- The Best Practice Principles for Governance Research Providers Group, formed as a result of the recommendations in ESMA's final report, published for comment on October 28, 2013 *Public Consultation on Best Practice Principles for Governance Research Providers*. Following the consultation, the Group

published in March 2014 a set of *Best Practice Principles for Providers of Shareholder Voting Research & Analysis*.

As a result of this renewed focus, proxy advisory firms are reviewing, and engaging in dialogue with market participants about, their practices to address the concerns raised by market participants. In light of the foregoing, we concluded that a policy-based approach providing guidance on recommended practices and disclosure for proxy advisory firms represents a sufficient and meaningful response to address the different perspectives of the respective market participant groups while recognizing the private contractual relationship between proxy advisory firms and their clients. We believe that the best practices recommended by the Proposed Policy are consistent with the recommendations arising from the international initiatives and can be implemented by international proxy advisory firms operating in other jurisdictions.

Summary of the Proposed Policy

The guidance contained in the Proposed Policy is intended to address the areas discussed below.

Conflicts of interest

There is general agreement amongst market participants of the potential for conflicts of interest in the proxy advisory industry. Potential conflicts of interest, including those related to the business model or the ownership structure of a proxy advisory firm, may compromise the independence of services provided by the proxy advisory firm.

We expect proxy advisory firms to identify, manage and mitigate actual or potential conflicts of interest. We suggest certain steps that proxy advisory firms may consider taking to address actual or potential conflicts of interest, including establishing policies and procedures, internal safeguards and controls and a code of conduct. We expect proxy advisory firms to disclose to their clients any actual or potential conflict of interest and to publicly disclose their policies and procedures, internal safeguards and controls and code of conduct. We also encourage proxy advisory firms to evaluate the effectiveness of their processes on a regular basis to ensure that they remain appropriate.

Transparency and accuracy of vote recommendations

Without appropriate disclosure of the processes leading to vote recommendations, market participants may not be able to question or evaluate the quality of the information, research and analysis that underlie the proxy advisory firm's vote recommendations, and

to evaluate their merits. Also, potential factual errors or inaccuracies in the proxy advisory firm's reports may lead to misinformed voting decisions by clients.

We expect proxy advisory firms to implement appropriate practices to promote transparency and accuracy of vote recommendations. Proxy advisory firms may consider, among other things, establishing and, where possible and without compromising the proprietary or commercially sensitive nature of information, disclosing policies and procedures describing the approach or methodologies used in the analysis as well as internal safeguards and controls to increase the accuracy and reliability of the information and data used in the preparation of vote recommendations. We encourage proxy advisory firms to ensure that they have the resources, knowledge and expertise required to perform their duties in the ordinary course of business.

Development of proxy voting guidelines

Because of their potential influence, proxy voting guidelines developed by proxy advisory firms may have an impact on the corporate governance practices of issuers. Market participants agree that proxy advisory firms should avoid a "one-size-fits-all" approach and should ensure that their proxy voting guidelines are tailored to the Canadian context.

To foster understanding among market and industry participants, we encourage proxy advisory firms to establish and, without compromising the proprietary or commercially sensitive nature of information, disclose policies and procedures describing the process followed in developing proxy voting guidelines and to engage with their clients, market participants and the public. We expect proxy advisory firms to publicly disclose their proxy voting guidelines and updates, and encourage proxy advisory firms to explain the rationale for their proxy voting guidelines.

Communications with clients, market participants, the media and the public

Although the services provided by proxy advisory firms are part of a contractual relationship with their clients, these services may have an impact on investors, issuers and the public when their comments or statements are reported in the press or public forums.

We expect proxy advisory firms to consider communicating certain information when issuing their vote recommendations to their clients in their reports, including any actual or potential conflicts of interest, the approach or methodologies used and a description of

the extent to which proxy voting guidelines are applied when preparing vote recommendations.

Although it is for proxy advisory firms to determine whether or not to engage with issuers when they prepare vote recommendations and if so, in what manner, we expect proxy advisory firms to publicly disclose their approach to any dialogue or contact with issuers.

We expect proxy advisory firms to publicly disclose their policies and procedures governing their communications with clients, market participants, the media and the public.

Corporate governance practices

Some issuers, issuer associations and law firms have raised concerns that proxy advisory firms may have become de facto corporate governance standard setters and that, as a result, issuers are compelled to adopt certain “one-size-fits-all” standards which may not be entirely suitable for their specific circumstances.

We wish to remind issuers that they may engage with their shareholders, who have the ultimately responsibility of determining how to exercise their right to vote, to explain why they have adopted a given corporate governance practice. Where appropriate, issuers may discuss corporate governance and proxy voting matters with institutional investors to address their concerns. If issuers have practices that are different from the standards set out in the proxy advisory firms’ proxy voting guidelines, these practices can be discussed with institutional investors.

The information circular is the primary means for issuers to communicate their corporate governance practices to their shareholders. An issuer can include in its information circular a comprehensive discussion of its approach to corporate governance, including the practices of the board of directors and the issuer’s executive compensation programs.

Issuers may also choose to participate in consultations organized by proxy advisory firms and to communicate their views on corporate governance issues and proxy voting guidelines. Such contacts may help both parties to better understand each other’s positions.

Remarks on Proposed Policy

We recognize that proxy advisory firms have demonstrated a willingness to respond to the concerns raised in the Proposed Policy and have brought changes to some of their practices. We intend to continue monitoring market developments in the proxy advisory industry to evaluate if the Proposed Policy addresses the Canadian marketplace's concerns.

Request for comments

We would appreciate feedback on the Proposed Policy generally, as well as on the following questions:

1. Do you agree with the recommended practices for proxy advisory firms? Please explain.
2. Are there any material concerns with proxy advisory firms that are not covered in the Proposed Policy? Please explain.
3. Will the Proposed Policy promote meaningful disclosure to the proxy advisory firms' clients, market participants and the public? If not, what additional information should be disclosed?
4. We encourage proxy advisory firms to consider designating a person to assist with addressing conflicts of interest. Should we also encourage proxy advisory firms to have the person assist with addressing determination of vote recommendations, development of proxy voting guidelines and communication matters?
5. We expect proxy advisory firms to disclose their approach regarding dialogue or contact with issuers when they prepare vote recommendations. Should we also encourage proxy advisory firms to engage with issuers during this process? If so, what should be the objectives and format of such engagement?
6. A proxy advisory firm may provide automatic vote services to a client based on the proxy advisory firm's proxy voting guidelines. Should we encourage proxy advisory firms to consider obtaining confirmation that the client has reviewed and agreed with the proxy advisory firm's proxy voting guidelines leading to vote recommendations? If so, should we

encourage proxy advisory firms to consider obtaining such confirmation annually and following any amendments to the proxy advisory firm's proxy voting guidelines?

We welcome your comments on the Proposed Policy and feedback on the specific questions we have posed.

Please note that comments received will be made publicly available and posted on the website of the Ontario Securities Commission at www.osc.gov.on.ca and on the website of the Autorité des marchés financiers at www.lautorite.qc.ca and may be posted on the websites of certain other securities regulatory authorities. Therefore, you should not include personal information directly in comments to be published. It is important that you state on whose behalf you are making the submission.

Please provide your comments in writing by June 23, 2014. Please provide your comments in Microsoft Word.

Please address your submission to all members of the CSA as follows:

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

Please deliver your comments only to the addresses that follow. Your comments will be distributed to the other CSA member jurisdictions.

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