

# POWER CORPORATION OF CANADA

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Registrar of Securities, Prince Edward Island  
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Re: Canadian Securities Administrators Consultation Paper 25-401 –  
Potential Regulation of Proxy Advisory Firms (the “Consultation Paper”)

We welcome the initiative of the Canadian Securities Administrators (the “CSA”) in considering the potential regulation of proxy advisory firms to address concerns raised about the activities of such firms and their potential impact on Canadian capital markets.

Proxy advisors currently wield significant influence within Canadian securities markets, functioning as both an unofficial developer and “enforcer” of governance standards, as well as an arbiter of fundamental transactions (e.g., mergers). Given the vital importance under Canadian securities laws of accurate disclosure regarding reporting issuers, as well as the maintenance of high standards of fitness and business conduct by market participants, we believe it is appropriate for the CSA to develop a securities regulatory framework that prescribes

expected actions and disclosures and otherwise holds such proxy advisory firms accountable for the accuracy, independence and reliability of their advice.

### **The Power Group**

Power Corporation of Canada ("Power Corporation"), as a diversified international management and holding company, has directly and indirectly invested many billions of dollars in Canada, the United States, Europe and Asia, in companies that are active in the financial services, communications and other business sectors. We are major long-term shareholders of companies, including Canadian public company subsidiaries, such as Power Financial Corporation (66.1%), Great-West Lifeco Inc.<sup>1</sup> and IGM Financial Inc.<sup>2</sup> In addition, Power Corporation has had a controlling shareholder since its beginnings in 1925 and its current controlling shareholder holds in aggregate, directly or indirectly, shares carrying 61.1% of the votes attached to our outstanding voting shares.

Power Corporation and its group companies are active participants in the public dialogue regarding shareholder democracy and corporate governance matters in Canada.

### **Necessity for Regulatory Oversight**

We understand that the demand for firms to assist in (i) aggregating information, (ii) providing research and analysis of matters to be decided at shareholder meetings, and (iii) facilitating voting on such matters by institutional investors, has grown rapidly over the past few decades and is expected to continue to do so. Accordingly, we believe it is important to acknowledge the significant role proxy advisors serve and recognize the positive contribution they can make to the corporate governance process, if properly regulated.

Strategically situated at the critical nexus of institutional investors, reporting issuers and shareholder democracy, a few proxy advisory firms have cultivated substantial, indirect rulemaking power, and operate much like governmental agencies or self-regulatory organizations, but without any of the usual regulatory checks and balances, appeals processes or other safeguards. In such role, these proxy advisors have evolved, without securities regulatory oversight in Canada, and in the absence of the discipline provided by vigorous competition, into *de facto* standard setters or private regulators in respect of corporate and securities legal matters that have important and long-term national policy implications.

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<sup>1</sup> Power Financial Corporation and IGM Financial Inc. hold 68.2% and 4.0%, respectively, of Great-West Lifeco Inc.'s common shares, representing approximately 65% of the voting rights attached to all outstanding Great-West Lifeco Inc. voting shares.

<sup>2</sup> Power Financial Corporation and The Great-West Life Assurance Company, a subsidiary of Great-West Lifeco Inc., hold 58.3% and 3.7%, respectively, of IGM Financial Inc.'s common shares.

Based on an accumulation of anecdotal evidence and as a logical extrapolation of empirical studies regarding the influence of proxy advisors in the U.S.<sup>3</sup>, we believe it is important for the CSA, through securities laws, to recognize their potential impact on the integrity of Canadian capital markets. As further discussed herein, the CSA should implement a unique and comprehensive framework to regulate proxy advisors, recognizing their distinct role and drawing upon the existing frameworks governing other market participants, as applicable.

While proxy advisors do not function as “dealers” or “advisors”, there is no principled basis for drawing a distinction between being in the business of advising with respect to investment in or the purchase or sale of securities and being in the business of advising with respect to the voting of securities. Further, while unlike credit rating agencies, proxy advisors do not have a formal role recognized in securities legislation, we are not convinced that the uniqueness of proxy advisors’ business models justifies the lack of their regulation as market participants. In particular, we are struck by some of the similarities between proxy advisory firms and credit rating agencies<sup>4</sup>, including the following: the use of an assessment system based on proprietary models; significant reliance by many investors on the firms’ views; industry dominance by a few firms; concerns regarding potential conflicts of interests; and concerns regarding the integrity of data on which the assessments are based. Although we are not specifically advocating for the adoption of a designation framework, we find many aspects of the recently adopted National Instrument 25-101 *Designated Rating Organizations* (“NI 25-101”) to be compelling in populating the fundamental components of a strong, coherent regulatory framework for proxy advisors. See Appendix A.

In the context of the current concerns and potential problems identified in the Consultation Paper (and in other documents published by regulatory authorities in the United States and across Europe), the CSA has an opportunity to implement warranted regulation and such oversight should be exercised promptly to address

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<sup>3</sup> See, among others: “The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policies” David F. Larcker, Allan L. McCall and Gaizka Ormazabal, *Stanford University, Rock Center for Corporate Governance Working Paper Series No. 119*, draft dated July 5, 2012 (the “Rock Centre Study”). The study concluded that proxy advisory firm recommendations have a substantive impact on say-on-pay voting outcomes. Similarly, the “2012 Say on Pay Results” report published by Semler Brossy (see [www.semmlerbrossy.com](http://www.semmlerbrossy.com)) found that a negative vote recommendation from ISS on say-on-pay will swing 30% of the total votes into the vote “no” column. See also the Special Report of the Altman Group, “Proxy Advisory Firms: The Debate Over Changing the Regulatory Framework” (at <http://www.altmangroup.com/pdf/TAGSpecRptProxyAdv.pdf>), analyzing the comments submitted in response to the SEC Concept Release on the U.S. Proxy System published on July 14, 2010 (the “SEC Concept Release”). The report discusses special instances (such as close votes) where the influence of proxy advisory firms far outweighs their typical influence across a broad sample base.

<sup>4</sup> See, in support of this assertion, the SEC Concept Release, at page 121: “Finally, in light of the similarity between the proxy advisory relationship and the “subscriber-paid” model for credit ratings, we could consider whether additional regulations similar to those addressing conflicts of interest on the part of Nationally Recognized Statistical Rating Organizations (“NRSROs”) would be useful responses to stated concerns about conflicts of interest on the part of proxy advisory firms.”

identified concerns, rather than in response to an actual, pervasive market failure. The chosen regulatory framework should contain prescriptive mandates (e.g., regarding issuer engagement, personnel competency and liability provisions) to hold proxy advisors accountable for the accuracy, independence and reliability of their advice, as well as requirements for increased disclosure to ensure that investors have adequate information to allow them to monitor the quality of the information provided by proxy advisors.

#### **Institutional Shareholder Services Inc. (“ISS”)**

As noted in the Consultation Paper, ISS is the dominant player in a highly concentrated proxy advisory industry in the United States. Our experience in Canada has been consistent with this description and, consequentially, this letter reflects only our familiarity with ISS and its operations. Accordingly, to the extent other proxy advisory firms’ businesses and processes differ from those of ISS, the regulatory framework developed by the CSA may need to prescribe further actions and disclosures, as appropriate, beyond those noted in this submission.

#### **Issuer Engagement**

While we believe that the Consultation Paper identifies and addresses a number of important concerns relating to the activities of proxy advisors, the concern with which Power Corporation has the most experience relates to issuer engagement. Given the fundamental importance under Canadian securities laws of accurate disclosure regarding reporting issuers, we are concerned about the current risk of inaccuracy in proxy advisors’ reports and voting recommendations and the absence of meaningful consequences for proxy advisors with respect thereof. In particular, we are concerned by the risk that, due to the same resource constraints that result in an investor’s engagement of a proxy advisor, the investor may review the incomplete, potentially insufficient, and possibly inaccurate information summarized in a proxy advisory report and not verify and consider, prior to voting, the detailed disclosure provided by the issuer in its management proxy circular or in other public documents.

Power Corporation has been the subject of erroneous reports by proxy advisors. In the past, we would annually review draft proxy voting reports and provide comments to the applicable proxy advisor in an attempt to correct factual and other errors contained in such reports. However, several years ago we determined that our comments were not adequately being taken into account by the proxy advisor and resolved to cease devoting significant resources to that consultative process. In 2009 for example, the proxy advisor failed to take into account 73% and 43%, respectively, of the corrections suggested by Power Corporation and by its subsidiary Power Financial Corporation. As a consequence, the published reports contained substantial factual inaccuracies. These concerns were further brought to the attention of the proxy advisory firm, but no response was ever received.

It is our belief that, during proxy season, it is appropriate for a proxy advisory firm to engage with issuers in all circumstances, not just on “contentious situations”<sup>5</sup>. Given the important role of proxy advisors in assisting investors in making voting decisions regarding matters at shareholder meetings and the consequential nature of the outcome of such votes (even on what may be viewed as routine matters<sup>6</sup>), it is essential that proxy advisory reports contain accurate information and that voting recommendations are based on an accurate interpretation and comprehensive review of publicly available information. The outcome for matters voted on by shareholders, even if not patently strategic, can have an impact on both the current and future financial performance and reputation of an issuer. Issuer engagement may also serve to better clarify an issuer’s understanding of the proxy advisor’s policies and reasons for its voting recommendations.

Given that there is sufficient time between the release of meeting materials and investors’ voting deadlines in Canada, a robust and credible issuer engagement process should be mandatory<sup>7</sup> if a proxy advisor is to issue a report on an issuer. It is unacceptable for a proxy advisor to cite resource constraints (see also “Resources” below)<sup>8</sup> as a reason for not engaging with an issuer – in such situations, the proxy advisor should refrain from issuing an advisory report. Any such issuer engagement must also involve a dialogue rather than an e-mail address or a portal for issuer submissions<sup>9</sup>. We appreciate that any such engagement should be limited to publicly available information (to the extent material) and, to maintain the independence of the proxy advisor’s process and advice, should not be viewed by issuers as a legislated right to lobby for a voting recommendation.

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<sup>5</sup> Per <http://www.issgovernance.com/policy/EngagingWithISS>: “During proxy season, [...], analysts will not generally be able to engage with issuers except on contentious issues: mergers, proxy contests, or other non-routine or extraordinary situations.” and “For non-contentious situations, it is the analysts’ discretion whether to engage further with the company after it has filed its proxy, and they generally only do so to clarify points on which they have questions.”

<sup>6</sup> For example, the importance to a director of being re-elected; the importance to an auditor of being re-appointed; the importance to executive officers of being compensated appropriately; and the importance to an issuer of having suitable directors elected, appropriate auditors appointed and executive officers retained through proper compensation arrangements.

<sup>7</sup> Per <http://www.issgovernance.com/policy/EngagingWithISS>: “Draft reports are provided in certain markets as a courtesy by and at the sole discretion of ISS, in order to allow an issuer to fact check the information prior to publication, thus allowing us to provide more accurate reports to our clients.”

<sup>8</sup> Per <http://www.issgovernance.com/policy/EngagingWithISS>: “During proxy season, [...], analysts will not generally be able to engage with issuers except on contentious issues...”

<sup>9</sup> Per <http://www.issgovernance.com/policy/EngagingWithISS>: “If there are particular points you want to be sure the analysts are aware of (for example, information relevant to a equity compensation plan that may be buried in a footnote, or corporate governance changes the company has undertaken), please send an email to Research Central with the points outlined and proxy page or other source noted - it will be put in the appropriate meeting folder so the analysts can review it when they are ready to do so.”

Further, in all cases<sup>10</sup>, issuers should be provided with a draft voting advisory report prior to its release, although issuers should be under no obligation to engage with the proxy advisor. In this respect, we are particularly supportive of the CSA making mandatory certain aspects that have been recommended in the French Autorité des marchés financiers *Recommendation No. 2011-06 of 18 March, 2011 on Proxy Advisory Firms* (the "AMF France Recommendation")<sup>11</sup>:

- the report must explain the reasons supporting the voting recommendations for each resolution, particularly with regard to the proxy advisor's published general voting policy;
- issuers should be given sufficient time<sup>12</sup> to provide comments or any feedback in respect of the draft report;
- at the issuer's request, the proxy advisor should be required to include the issuer's comments on the voting recommendations in the final report, on the condition that any such comments are concise, help the shareholders understand the draft resolutions on which they are to vote, and do not include discussion on the general voting policy;
- the proxy advisor should at all times be required to correct any substantive error found in its draft report and ensure that any such correction is submitted to its clients as quickly as possible; and
- the proxy advisor should be required to send the issuer in question its final analysis report as early as possible, and at the same time as it is submitted to the proxy advisor's clients.

We recognize that the provision of a draft voting advisory report to an issuer should be made subject to appropriate safeguards<sup>13</sup>.

It is our belief, which belief is shared by ISS<sup>14</sup>, that issuer engagement and a formal review process would improve the accuracy and quality of analyses by

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<sup>10</sup> Per <http://www.issgovernance.com/policy/EngagingWithISS>: "[...] ISS does not normally allow preliminary reviews of any analysis relating to any special meeting or any meeting where the agenda includes a merger or acquisition proposal, proxy fight, or any item that ISS, in its sole discretion, considers to be of a controversial nature."

<sup>11</sup> Consider also, in particular, items 2.6 and 4.12 of NI 25-101, which are noted in Appendix A.

<sup>12</sup> We believe sufficient time for issuer review to be at least two business days and that two to three weeks will provide sufficient time for completion of a meaningful dialogue between an issuer and proxy advisor regarding any factual errors or other disagreements concerning the application of the proxy advisor's policies to the issuer.

<sup>13</sup> We do not take issue with ISS's assertion, at [http://www.issgovernance.com/policy/FrenchEngagement\\_Disclosure](http://www.issgovernance.com/policy/FrenchEngagement_Disclosure), that "Proxy advisory reports are copyrighted works which are the valuable intellectual property of ISS. Any prior disclosure of our research reports to issuers, whether in France or elsewhere, is made on the condition of strict confidentiality and under no circumstances is an issuer to publish or otherwise disseminate all or part of the report."

<sup>14</sup> Per [http://www.issgovernance.com/policy/FrenchEngagement\\_Disclosure](http://www.issgovernance.com/policy/FrenchEngagement_Disclosure): "For a number of years, ISS has been providing French corporate issuers with an opportunity to review the

proxy advisors. We further believe that a lack of adequate issuer engagement by a proxy advisor could reasonably be expected to create a significant risk of harm to a subject issuer or the issuer's investors and that, accordingly, a securities regulatory response is warranted.

### **Report Disclosure Liability**

The decoupling of economic interest and vote decision-making that is inherent in the business model of proxy advisory firms necessarily results in proxy advisors operating without proportionate economic exposure to the consequences of faulty disclosure, advice and, ultimately, voting decisions.

Canadian securities laws have high expectations regarding the level of detail and accuracy of information required to be disclosed by issuers in the context of matters to be considered at shareholder meetings. In particular, if action is to be taken on any such matter, other than the approval of annual financial statements, issuers are required to briefly describe the substance of the matter<sup>15</sup> in sufficient detail to enable reasonable securityholders to form a reasoned judgment concerning the matter. Rules concerning information circulars in respect of business combinations, related party transactions, take-over bids and issuer bids also mandate disclosure of all matters that would reasonably be expected to affect the decision of securityholders. Further, information circulars concerning take-over bids and issuer bids must contain executed certificates attesting that such documents contain no untrue statement of a material fact and do not omit to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

Reflecting the importance of disclosure in an information circular, applicable Canadian securities legislation regards such a document as a "core document" for purposes of civil liability for secondary market disclosures. To the extent that the disclosures contained in reports (or included, summarized or quoted in other documents) released by or with the consent of proxy advisors alter the mix of available information through the inclusion of an untrue statement of a material fact (e.g., an erroneous voting recommendation based on an untrue factual support for such a recommendation) or omits to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made (e.g., the absence of a sufficient explanation regarding the voting recommendations included in the report), we believe that there should be an appropriate liability regime for proxy advisors. As the sole purpose of a proxy advisor's voting report is to provide a voting recommendation, any error in such a report would likely be considered important to a reasonable shareholder in deciding how to vote on a matter. Considering

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factual accuracy of the data included in ISS' pending proxy analyses. ISS believes that this review process helps improving the accuracy and quality of its analyses, an outcome that is in the best interests of both the institutional investors for whom the analyses are prepared, as well as for the issuers that are the subject of these reports."

<sup>15</sup> Such matters are noted as including alterations of share capital, charter amendments, property acquisitions or dispositions, reverse takeovers, amalgamations, mergers, arrangements or reorganizations and other similar transactions.

the significant economic and reputational consequences that inaccurate or incomplete information concerning matters to be voted upon at a shareholder meeting can have on issuers and other stakeholders, proxy advisors should be held accountable for the content of their reports.

### **Policy Formulation/Application and Disclosure of Policies**

Although it is our view that issuer engagement during the policy formulation process is imperative, we are sensitive to the fact that proxy advisors function pursuant to contractual relationships with their customers and, accordingly, their policies may primarily reflect the views of their customers. However, given the significance of their influence, we believe that policies developed and supported by proxy advisory firms should be clear, robust and based on empirical evidence, while also being flexible enough to appropriately contemplate and accommodate the approaches to governance that issuers thoughtfully determine to be appropriate for their unique circumstances. For example, there are legitimate governance differences for controlled companies like Power Corporation and our controlled public company subsidiaries. A “one-size-fits-all” approach is clearly inappropriate. In addition, policies of proxy advisory firms should be formed and applied in a manner that reflects the diversity of businesses and structures that comprise Canada’s capital markets<sup>16</sup>, whether a subject issuer be a seasoned or start-up issuer, a utility or growth company, a holding company or manufacturer, or a financial services or mining issuer, for example<sup>17</sup>. Surely this must also be the expectation of the institutional investors that subscribe to the services of proxy advisors.

We are also concerned that proxy advisors may be subject to commercial pressure to add new elements to their policies and guidelines each year to increase revenues and entrench their engagement by clients. The end result is that changes in governance policies promoted by proxy advisors may be taking place faster than warranted and before their impact is fully understood. In order

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<sup>16</sup> Consider support for this assertion found in the personal remarks of Troy A. Paredes (Commissioner) of the U.S. Securities and Exchange Commission at Society of Corporate Secretaries & Governance Professionals, 66th National Conference on “The Shape of Things to Come” on July 13, 2012 (retrieved from <http://www.sec.gov/news/speech/2012/spch071312tap.htm>): “Not only is it important for regulators to recognize that one-size-fits-all governance and pay practices don’t work so well for most companies, but board members, officers, investors, and other corporate constituencies also should recognize that each company is unique. Proxy advisory firms should keep this in mind too given the understandable concern that has been raised that the recommendations of proxy advisory firms are too often based on a one-size-fits-all view of things. Indeed, given other concerns that have been expressed about proxy advisory firms – including that conflicts of interest may bias their recommendations and that their recommendations may be based on inaccurate information – it seems to me that the role of proxy advisory firms needs to be addressed.”

<sup>17</sup> Consider also, in particular, item 2.1 of NI 25-101, which is noted in Appendix A.



to control such occurrences, proxy advisors should be required to disclose the empirical evidence supporting any change in their guidelines.<sup>18</sup>

Proxy advisors should also be required to disclose the internal procedures, guidelines, standards, methodologies, assumptions and sources of information supporting their recommendations, including in respect of their data-gathering procedures. Such disclosure should be sufficient to: permit the clients of proxy advisors to assess the quality of the data and analysis that inform voting recommendation and evaluate such recommendations on their merits; and allow issuers to form a reasonable expectation of voting recommendations in advance, without the issuer being required to purchase services and advice from the proxy advisor. Such disclosure should also state the number of companies each analyst reviews within a given time frame and whether or not the voting recommendations are subject to a second level of review by a senior analyst or manager.

### Resources

As noted in the European Securities and Markets Authority Discussion Paper *An Overview of the Proxy Advisory Industry - Considerations on Possible Policy Options*, dated March 22, 2012 (the "ESMA Paper"), "the availability of skilled and knowledgeable proxy advisor staff is a key factor in the production of accurate, independent and reliable proxy research and advice"<sup>19</sup>. The ESMA Paper further provides: "... it has been suggested to us that one of the challenges, bearing in mind the seasonal nature of the general meetings season, is the scarcity of skilled and knowledgeable staff in the industry, including skills to appropriately consult with issuers and investors. This results in, according to some feedback to the ESMA survey, a need to recruit (less experienced) temporary staff during the busier general meeting season or in outsourcing some of the work. [...] Temporary staff could therefore create a risk of less adequate or less accurate research and advice being prepared in relation to specific issuers, particularly bearing in mind the large number of issuers being analysed, and the very tight deadlines involved. As a result, specific factors or issues related to issuers may not always appropriately be taken into account."<sup>20</sup>

To the extent that the observations contained in the ESMA Paper also apply in the Canadian context (and the underlying contributing factors would appear to be similar across markets<sup>21</sup>), Power Corporation is concerned that, absent proper

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<sup>18</sup> See Romano, Roberta; Bhagat, Sanjai; and Bolton, Brian, "The Promise and Peril of Corporate Governance Indices" (2008). *Faculty Scholarship Series*. Paper 1920, which concludes that there is no consistent relation between governance indices and measures of corporate performance. See also the Rock Centre Study, which concludes that the proprietary models used by proxy advisory firms for say-on-pay recommendations appear to induce boards of directors to make choices that decrease shareholder value.

<sup>19</sup> At paragraph 84.

<sup>20</sup> At paragraph 85.

<sup>21</sup> According to <http://www.issgovernance.com/files/ISSDueDiligenceCompliancePackage.pdf> (dated July 2010), "ISS' research staff is comprised of more than 200 research analysts and 75 data analysts, located in financial centers worldwide.", while according to the Form 10-K filed

regulation, any such limitations in resources may lead to the application of automatic, "check-the-box" approaches by proxy advisors, through the automation of a large portion of the assessment process to leverage simplistic analytic models designed to avoid particularized research or the application of meaningful judgment. Any such business model places the integrity of Canadian capital markets at risk.

We acknowledge that the proxy season in Canada is concentrated within a few months and that, like any seasonal business, proxy advisor resources can be expected to be strained during peak periods. Further, we acknowledge that as the focus on shareholder involvement in corporate governance (e.g., shareholder proposals) and compensation matters (e.g., the advent of say-on-pay votes), as well as other matters for which shareholder approval is required (e.g., shareholder rights plans), has increased, the demand for the services of proxy advisors has grown and is expected to continue to grow. We also recognize that investors are unwilling to pay limitless amounts for voting services. However, given the fundamental importance under Canadian securities laws of the maintenance of high standards of fitness and business conduct by market participants, we do not view these as acceptable reasons for any diminution in the regulatory expectations that should be placed on proxy advisory firms.

Regulation of proxy advisory firms should ensure that such firms deploy sufficient resources to carry out high-quality assessments of each proxy matter for which advice is to be provided by having employees with appropriate knowledge, qualifications and experience for the duties assigned and with respect to the subject matter of voting recommendations (e.g., compensation policies, industry-specific aspects of complex merger and acquisition transactions, etc.)<sup>22</sup>, as well as appropriate time to consider such matters fully, after sufficient engagement with issuers, rather than just through a mechanical, "check-the-box" approach. In this respect, like other market participants, employees of proxy advisors involved in policy formulation or application should be subject to competency requirements (i.e., minimum standards and qualifications, as well as testing, concerning subject matter proficiency). We believe that such concerns would be best addressed through the implementation of a registration framework for proxy advisor personnel, similar to the one applicable to investment advisers, but taking into account the specificities of the proxy advisory context.

The availability of resources and the competency of proxy advisor personnel are particularly important when one considers that proxy advisors are not subject to duties comparable to those imposed on an issuer's directors by Canadian corporate statutes. In exercising their powers and discharging their duties,

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by RiskMetrics Group Inc. with the SEC on February 24, 2010, "During the proxy season (March to July), ISS typically retains approximately more than 200 temporary employees."

<sup>22</sup> AMF France Recommendation provides that "the proxy advisory firm should dispose of the appropriate skills and resources to provide the relevant services, and especially to analyse draft resolutions. The persons in charge of examining draft resolutions must have adequate skills and experience to conduct this type of analysis." Consider also, in particular, items 2.5, 2.7 and 2.13 of NI 25-101, which are noted in Appendix A.

including when contemplating recommending a matter to be voted upon by shareholders, members of a corporation's board (or a special committee of the board specifically formed for such purposes) must act honestly and in good faith with a view to the best interests of the corporation and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Accordingly, directors are required to devote sufficient time to considering such matters and, to the extent necessary, draw upon the available expertise of their advisors. If proxy advisory firms are to consider proposing to shareholders recommendations that are contrary to those of an issuer's directors, it is reasonable to require that such firms allocate sufficient, appropriately qualified resources to analyze matters presented for shareholder approval.

### **Potential Conflicts of Interest**

We believe that the objectivity of voting advice is of critical importance and, if left unregulated, conflicts of interest can compromise the independence of vote recommendations and risk negatively impacting on the integrity of Canadian capital markets. Regulation of proxy advisors should address potential conflicts of interest in order to safeguard against potential market failures.<sup>23</sup> In addition to the conflicts of interest specifically outlined in the Consultation Paper, the regulatory framework should also cover the following potential situations:

- analysts or executives within a proxy advisor have an ownership interest in or serve on the board of directors of issuers that have proposals on which the proxy advisor is offering vote recommendations;
- an institutional investor client instigates a "vote no" campaign in respect of a proposal, on which a proxy advisor is offering a vote recommendation;
- an institutional investor client is also a public company whose own proxies are the subject of a proxy advisor's analyses and voting recommendations; and
- the inherent forward-looking conflict of interest embedded in certain policy formulations (e.g., "say-on-pay": a proxy advisor has a clear business interest in seeing say-on-pay becoming universally adopted so that every issuer's compensation practices would have to be evaluated annually).

Proxy advisors should be required to establish, maintain, enforce and disclose publicly written policies and procedures to address and manage conflicts of interests. Also, we believe that proxy advisors should be required to provide timely, clear and specific disclosure of any actual or potential conflict of interests they identify. A generic disclosure that a conflict of interest *may* exist in the

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<sup>23</sup> Consider also, in particular, items 3.4, 3.5, 3.7 and 3.8 of NI 25-101, which are noted in Appendix A.

circumstances is insufficient in our opinion. Finally, the CSA should consider whether disclosure may be insufficient to protect against the consequences of certain types of conflicts of interests, that go directly to the proxy advisor's decision making ability and whether such conflicts should not be instead prohibited.

### **NI 51-102 Disclosure of Proxy Advisor Consulting Services**

The CSA should **not** propose in our view an amendment to NI 51-102 to require reporting issuers to disclose consulting services from proxy advisors in their proxy circular. The appropriate location for any such notice would be as part of the conflict of interest disclosure within a proxy advisor's voting report. Disclosure in a reporting issuer's proxy circular would serve no additional purpose and, in fact may exacerbate the current issues contemplated by the Consultation Paper. In particular, any such disclosure could risk overstating the relevance of the involvement of a proxy advisor as a positive influence on an issuer's governance practices, functioning as a "seal of approval" which pressures issuers into employing the services of proxy advisory firms.

### **Conclusion**

Proxy advisors are significantly involved in establishing and enforcing governance standards in Canada. Given the fundamental importance under Canadian securities laws of accurate disclosure regarding reporting issuers, as well as the maintenance of high standards of fitness and business conduct by market participants, we believe it is appropriate for the CSA to develop a securities regulatory framework commensurate with the significance of the role served by proxy advisors. Such a regulatory framework should prescribe expected actions and disclosures and otherwise hold such firms accountable for the accuracy, independence and reliability of their advice. The CSA should act promptly, rather than in response to an actual, pervasive market failure.

Representatives of Power Corporation would be pleased to discuss with representatives of the CSA the foregoing, including specific examples of our experience with proxy advisory firms, if that would be of assistance.

Yours very truly,



Stéphane Lemay

SL/ms

## Appendix A

POWER CORPORATION OF CANADA

In establishing a regulatory framework governing proxy advisory firms, we find that many aspects of Appendix A to the recently implemented NI 25-101 to be compelling, including, but not limited to, the following items:

- 2.1 A designated rating organization must adopt, implement and enforce procedures in its code of conduct to ensure that the credit ratings it issues are based on a thorough analysis of all information known to the designated rating organization that is relevant to its analysis according to its rating methodologies.
- 2.5 [...] The designated rating organization will ensure that its ratings employees and agents have appropriate knowledge and experience for the duties assigned.
- 2.6 The designated rating organization, its ratings employees and its agents must take all reasonable steps to avoid issuing a credit rating, action or report that is false or misleading as to the general creditworthiness of a rated entity or rated securities.
- 2.7 The designated rating organization will ensure that it has and devotes sufficient resources to carry out high-quality credit assessments of all rated entities and rated securities. When deciding whether to rate or continue rating an entity or securities, the organization will assess whether it is able to devote sufficient personnel with sufficient skill sets to make a credible rating assessment, and whether its personnel are likely to have access to sufficient information needed in order make such an assessment. A designated rating organization will adopt all necessary measures so that the information it uses in assigning a rating is of sufficient quality to support a credible rating and is obtained from a source that a reasonable person would consider to be reliable.
- 2.13 The designated rating organization will ensure that adequate personnel and financial resources are allocated to monitoring and updating its credit ratings. Except for ratings that clearly indicate they do not entail ongoing monitoring, once a rating is published the designated rating organization will monitor the rated entity's creditworthiness on an ongoing basis and, at least annually, update the rating. In addition, the designated rating organization must initiate a review of the accuracy of a rating upon becoming aware of any information that might reasonably be expected to result in a rating action (including termination of a rating), consistent with the applicable rating methodology and must promptly update the rating, as appropriate, based on the results of such review.
- 3.4 The designated rating organization will not allow its decision to assign a credit rating to a rated entity or rated securities to be affected by the existence of, or potential for, a business relationship between the designated rating organization or its affiliates and any other person or company including, for greater certainty, the rated entity, its affiliates or related entities.
- 3.5 The designated rating organization and its affiliates will keep separate, operationally and legally, their credit rating business and their rating employees from any ancillary services (including the provision of consultancy or advisory services) that may present conflicts of interest with their credit rating activities and will ensure that the provision of such services does not present conflicts of interest with their credit rating activities. The designated rating organization will define and publicly disclose what it considers, and does not consider, to be an ancillary service and identify those that are ancillary services. The designated rating organization will disclose in each ratings report any ancillary services provided to a rated entity, its affiliates or related entities.

- 3.7 The designated rating organization will identify and eliminate or manage and publicly disclose any actual or potential conflicts of interest that may influence the opinions and analyses of ratings employees.
- 3.8 The designated rating organization will disclose the actual or potential conflicts of interest it identifies under section 3.7 in a complete, timely, clear, concise, specific and prominent manner.
- 4.12 Before issuing or revising a rating, the designated rating organization will inform the issuer of the critical information and principal considerations upon which a rating will be based and afford the issuer an opportunity to clarify any likely factual misperceptions or other matters that the designated rating organization would wish to be made aware of in order to produce an accurate rating. The designated rating organization will duly evaluate the response.