DAVIES

DAVIES WARD PHILLIPS & VINEBERG LLP

44th Floor
1 First Canadian Place
Toronto Canada M5X 1B1

Tel 416 863 0900
Fax 416 863 0871
www.dwpv.com

September 20, 2012

Carol Hansell
Dir 416 863 5592
CHansell@dwpv.com

File No. 99003

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

CSA Consultation Paper 25-401

Thank you for the opportunity to comment on the Canadian Securities Administrators' Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms (the "Consultation Paper"). The Consultation Paper provides very helpful analysis and comparatives that will serve to move forward the understanding of the role played by proxy advisors. In addition, the comments the CSA receives in response to the Consultation Paper, particularly those that provide the data that is missing from the current debate, will play an important role in addressing potential issues arising from such role.

We have set out our responses to the analysis in the Consultation Paper under the following headings:

1. Scope of the Problem
2. Annual Meeting Issues
3. Special Transactions
4. Potential Solutions

1. Scope of the Problem

Proxy advisors play an increasingly important role in the capital markets. They can influence both institutional investors and retail investors through the recommendations made to their clients and, frequently, the subsequent publication of those recommendations in the media. In the context of contested or controversial business at an annual meeting or business combination transactions, recommendations made by proxy advisors can be very important in shifting momentum for or against the proposals made by management or dissident shareholders.

The Consultation Paper refers to certain concerns expressed by issuers about the influence of proxy advisors on the outcome of shareholder meetings in Canada. While there are other concerns, the primary concerns of our issuer clients typically are that the facts on which proxy advisors rely are sometimes incorrect, the analysis and recommendations provided by proxy advisors to their clients are sometimes flawed, and the process by which such recommendations are formulated lacks transparency. Based on the input we have received from our issuer clients, we are concerned that it may not always be apparent to investors when a proxy advisor's report contains incorrect information or flawed analysis.

Our institutional investor clients believe that proxy advisors offer a valuable service which is helpful to them in the discharge of their responsibilities to their clients and beneficiaries. We understand that they do not generally perceive a systemic problem with the quality of recommendations provided to them by proxy advisors. In any event, the largest institutional investors have the internal resources to analyze proxy circulars and review the reports of the proxy advisors. For these investors, the reports of the proxy advisors are just one resource they may use in formulating their voting decisions.

We appreciate the role that the responses to the Consultation Paper will play in enhancing the understanding of all parties about the scope of the issues that need to be addressed with respect to proxy advisors from a regulatory perspective. In our view, there are two considerations that would determine whether regulatory intervention is appropriate. The first consideration is the degree of influence proxy advisors have on the way in which their clients vote. The second consideration is whether any flaws in the information in a proxy advisor's reports or analysis have, or are reasonably likely to have, a material impact on the proxy advisor's recommendation.

a. Influence of Proxy Advisors

Proxy advisors have a broad range of clients, from Canada's largest institutional investors to much smaller funds. The extent to which a proxy advisor influences the votes of its clients may depend in part on the resources of the client and the size of the client's investment in the applicable issuer. As noted above, we understand that large institutional investors often use the research and recommendations of proxy advisors as one input in making their voting decisions. These investors have significant capability to review and

analyze not just the issuer's circular, but other sources of research and analysis, including the reports issued by the proxy advisors. Smaller investors often do not have those resources and so many find it more cost effective to outsource those functions to proxy advisors. The clients and beneficiaries of smaller institutions may not be willing to absorb the additional fees necessary to finance a more sophisticated in-house proxy voting function.

Proxy advisors influence the way in which their clients vote as a result of at least two factors. The first is reliance. It is sometimes suggested that institutional investors rely on the recommendations of the proxy advisors without exercising their own judgement. We are not suggesting that this is the case. Nevertheless, we have the following observations:

- While large institutional investors develop their own proxy voting guidelines, we understand that they typically use the voting recommendation of the proxy advisors as one input into their decisions.

- Not every investor values the right to vote. In fact, some are indifferent to the outcome of the vote. This may be the case for passively managed funds, for example, such as index funds or funds holding a basket of equities in connection with a structured product. The investment objective for these funds is to track the performance of an underlying index, sector or group of issuers and not to use their votes to influence shareholder resolutions. Although these funds vote the shares in which they are invested (perhaps in the belief that they have a duty to do so), they often do so in accordance with a proxy advisor's policy (possibly customized to some extent). The performance objectives of passively managed funds are not consistent with devoting resources to re-evaluating their voting policies on an issuer by issuer basis.

- Smaller institutional investors may adopt the proxy voting guidelines developed by one of the proxy advisors and sometimes customize them. For a number of reasons, including the size of their holdings, these investors may generally vote in accordance with the policy they have adopted and be prepared to override that policy only in exceptional circumstances. The internal approvals required to override the policy may create a disincentive for the person responsible for casting the vote to vote contrary to the policy unless the case for an override is highly compelling. The tendency to vote in accordance with the policy that the institutional investor has adopted is even greater when the investor uses a voting platform (whether offered by a proxy advisor or by Broadridge) which provides the investor with voting instruction forms that have been pre-populated to comply with that policy. Although the investor always has the option to change their vote from what is set out in the pre-populated form, we are concerned that the default position in some cases is to remain aligned with the policy. Furthermore, in the case of business combinations or other special transactions, the proxy advisor's

recommendation does not result from the application of a policy developed by the proxy advisor which an investor may elect to adopt as part of its own policy or not. If the investor does not have internal resources to evaluate the transaction itself, it may be inclined to simply the proxy advisor's recommendation

The second way in which proxy advisors may have influence over clients is by the confidence their clients have in their analysis and in their recommendations. Larger institutional investors often are able to compare the analysis of the proxy advisors with their own analysis and conclusions. Smaller institutions may have no basis on which to question the analysis presented by the proxy advisor, but may have confidence that the proxy advisor's research and analysis is generally conducted appropriately.

We are concerned that in some cases, this confidence is misplaced. Specific problems raised by our issuer clients include:

- the issuer's public disclosure being picked up incorrectly in the report of the proxy advisor (in one case a director was mischaracterized as being non-independent);

- allegations regarding the issuer and its management made publicly by an investor being accepted as correct and included in the proxy advisor's report without allowing the issuer to address any concerns that these allegations raised before the proxy advisor's recommendation was issued;

- a proxy advisor's report incorrectly describing important aspects of certain critical contractual arrangements as well as the process followed by a party in connection with the negotiation of a business combination transaction; and

- a proxy advisor miscalculating the value offered in a significant business combination.

In each of these instances, the voting recommendations made were based upon flawed information and/or analytics.

The analysis and recommendations made by proxy advisors are often repeated in the press and therefore their influence extends beyond their own clients to other institutional clients and retail investors. Furthermore, the perceived validation provided by the proxy advisor may add credibility to a particular position on a contested issue. This is particularly the case in light of the widespread public perception (whether or not correct) that the proxy advisors offer analysis which is uninfluenced by the position taken by others.

Finally, portions of a proxy advisor's report on one of our issuer clients were incorporated out of context in a press release issued by a party opposed to management's recommendations, making it seem as though the proxy advisor had advised against the transactions, when it had not. The press release traded on the proxy advisor's credibility,

but used it to mislead investors. While we recognize that this is not the fault of the proxy advisor, we did think it would be helpful to bring this type of incident to the attention of the CSA in the context of this discussion.

b. Materiality of Flaws in Analysis and Recommendations

The second factor that would determine whether regulatory intervention is appropriate is whether the flaws in the analysis and recommendations of proxy advisors have a material impact on the outcome of individual meetings. We emphasize that the issue is not whether the problems are material for all meetings. In our view, it should concern the regulators if these issues are material to individual meetings. Hopefully this will be in the information that becomes available through the comment process on the Consultation Paper.

2. Annual Meeting Issues

Annual meetings have become less routine over the last several years, as a result of majority voting and say on pay, among other things. While shareholders cannot bind the board as a result of either vote, boards are increasingly alert to the messages sent by shareholders through their votes on these issues.

On many issues, proxy advisors are clear about the positions that they will take and, accordingly, issuers often align their compensation and other practices with the guidelines of the proxy advisor. In our view, the guidelines established by proxy advisors represent an approach to compensation and governance which is not appropriate for all issuers in respect of which a proxy advisor issues recommendations. If an issuer chooses not to align its practices with those recommended by a proxy advisor, it will have the opportunity to make its case both through its disclosure materials and through individual meetings with investors (and in some cases with the proxy advisor). However, we note that, for the reasons described above, as a practical matter it is often difficult for issuers to persuade institutional shareholders to vote in favour of management's view where it differs from the proxy advisors' guidelines. As a result, issuers may feel they must follow the proxy advisors' compensation and governance guidelines even if an alternative approach might be more appropriate for the issuer.

One area which our issuer clients find particularly frustrating is stock option plans. The methodology used by proxy advisors to evaluate a stock option plan or amendment to a stock option plan – particularly its dilutive effect – frequently is not published or available to issuers. An issuer is too often surprised that a proxy advisor is recommending against its plan or an amendment to its plan. Similar concerns exist in other areas where proxy advisors have unpublished policies that affect their recommendations.

We are concerned about how proxy advisory firms source some of their information. A recent report and voting recommendation of the Social Advisory Services branch of ISS[1] repeated a number of highly damaging allegations about one of our issuer clients originally made by special interest groups, without confirming the allegations with information from a reliable source. Many of the allegations were taken from anonymous anti-industry websites and blogs. The proxy advisor also did not consult with the issuer regarding the allegations prior to issuing the report in order to bring balance or objectivity to the analysis. After the report was issued and brought to the attention of the issuer, the proxy advisor was unwilling to remove the unsubstantiated allegations from its report or supplement the report with the issuer's position on the allegations (although some factual inaccuracies were rectified). The report did not identify the sources of the information relied upon and therefore readers of the report had no basis upon which to assess or even question the credibility of the allegations repeated in the report.

Contested director elections are a particularly sensitive issue, since the outcome of the election can affect the issuer's strategic direction. The analysis necessary to recommend one director candidate over another may involve many of the same issues of expertise and judgement discussed below in the context of special transactions. This may not be a concern for all contested director elections, but is certainly relevant in some.

3. Special Transactions

Business combinations and other special transactions ("Special Transactions") that require shareholder approval give rise to additional concerns relating to the role of proxy advisors. The very nature of a Special Transaction means that a proxy advisor will generally have no policy against which to assess the transaction. Accordingly, the issuer cannot anticipate and address concerns that the proxy advisor may have.

Properly evaluating Special Transactions almost always requires expertise, including technical expertise and industry expertise, which may go beyond what is required to make recommendations with respect to customary annual meeting business. We recognize that proxy advisors often have in house expertise that includes investment banking and accounting. Based on some of our issuer clients' experiences, however, often the proxy advisor may not have, or be applying appropriately, the expertise necessary to comment on management's recommendations in respect of Special Transactions.

Often proxy advisors' recommendations in respect of Special Transactions are based on an assessment of the relative value of the consideration offered and the securities to be acquired. The recommendation and related analysis of value will be disclosed in the proxy advisor's report, but the level of disclosure relating to the principal judgments and underlying reasoning applied in reaching the proxy advisor's value conclusions varies. Although issuers are required to provide sufficient disclosure with respect to their

---

[1] This branch of ISS issues voting recommendations in addition to and separate from those issued by ISS.

recommendations to allow shareholders to make a reasoned decision, no such standards apply to proxy advisors. In our view, the reader of a proxy advisor's report may not always receive enough information from the report to allow them to form a reasoned judgment about the proxy advisor's recommendations. Readers would also benefit from disclosure about the experience and qualifications of the individuals who have contributed to or taken responsibility for the recommendation.

Some of our issuer clients have been unsuccessful in engaging with a proxy advisor in a meaningful way prior to the issuance of the proxy advisor's recommendation. In our view, where a Special Transaction is being put to a shareholder vote and the proxy advisor proposes to issue a recommendation with respect to the Special Transaction, the proxy advisor should engage with the issuer if the issuer requests such engagement. We appreciate that this may involve greater costs for the proxy advisor and therefore higher fees for their clients, but we believe that the public policy imperative for improved quality and balanced analysis by influential market players justifies these additional costs and fees.

Proxy advisors do not rely exclusively on an issuer's public disclosure in formulating their recommendations. They often meet with a number of shareholders of the issuer as a part of the process of developing recommendations. Some of such shareholders may also be clients of the proxy advisor, which raises the question of whether such a client relationship may give these shareholders disproportionate influence over the proxy advisor's recommendation. Users of recommendations made by proxy advisors do not know which shareholders may have provided input into the formation of the recommendation. This information may be relevant in assessing the analysis and recommendations included in the proxy advisor's report.

4. Potential Solutions

As indicated above, we believe that clients of proxy advisors generally have confidence in their analysis and many (likely smaller investors) have adopted proxy voting guidelines that are the same as, or at least largely based on, the proxy voting guidelines recommended by a proxy advisor. It also is the case that the publication or other dissemination of the recommendations and analysis of proxy advisory firms can have a material impact on the voting decisions of investors, both institutional and retail, who are not clients of such firms.

We believe that an appropriate objective from a regulatory perspective is to ensure that investors have all of the information they need in order to make a reasoned judgement about how to cast their vote and that such information is accurate. Issuers are subject to strict disclosure requirements under securities laws, and sometimes believe that their carefully vetted disclosure is being undercut with impunity by proxy advisors whose analysis and recommendations are flawed.

Given that the ultimate objective is to provide accurate information and appropriate transparency to the investor, we favour a protocol that would do the following:

- require the proxy advisor to send the draft report to the issuer at least 48 hours before it is issued. Where a dissident has prepared and mailed a circular to all shareholders (a "Dissident"), the proxy advisor should provide the draft report to the Dissident at the same time;

- require the proxy advisor to review the comments of the issuer and the Dissident, if applicable, on the draft report;

- include in the final report a summary of substantive comments provided by the issuer and the Dissident, if applicable, that the proxy advisor has not accepted;

- require the proxy advisor to provide a copy of the final report to the issuer and the Dissident, if applicable, concurrent with its distribution to the proxy advisor's clients;

- require that the report be issued no later than a prescribed number of days prior to the proxy cut-off for the applicable shareholders meeting in order to give the issuer (and Dissident, if applicable) a reasonable opportunity to address with investors the content of the proxy advisor's report;

- require the proxy advisor to identify the sources of the factual information contained in its report where the information is not contained in the issuer's (or Dissident's) public filings;

- require the proxy advisor to identify if they met with shareholders and/or clients in connection with formulating their recommendation;

- require the proxy advisor to include in its reports clear disclosure that the proxy advisor is not independent (in the sense that it is providing services for a particular group of investors who are its clients) and that the report may reflect the views of the proxy advisor's clients;

- require the proxy advisor to disclose if the issuer or Dissident, if applicable, is a client of the proxy advisor; and

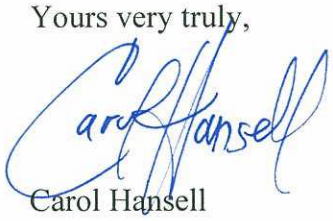
- require the proxy advisor to include in each report, information regarding the qualifications (*e.g.*, education and relevant work experience) of the person(s) with primary responsibility for the report.

We do not think that initially this protocol should be required or enforced by the CSA. Rather, the adoption of such a protocol should be recommended by the CSA in a National Policy. The CSA should also receive comments from issuers who believe that a proxy advisor is not adhering to the protocol or who believe that the recommendation of a proxy advisor has influenced the results of a shareholder vote inappropriately (*i.e.*, on the basis of incorrect facts or flawed analysis). We suggest that the CSA revisit the issues relating to proxy advisors within a reasonable period of time after the protocol is initially recommended to obtain feedback on whether the concerns raised have been successfully addressed or whether further regulatory involvement is required.

Thank you for this opportunity to comment on the Consultation Paper. We appreciate the efforts of the CSA to bring some focus to the important issues discussed in that paper. We encourage the CSA to continue its review of the proxy voting system and, in particular, those elements of the mechanics of the proxy voting system that are widely acknowledged to compromise (or have the potential to compromise) the quality of shareholder voting in Canada. We refer you to our paper on that topic, which can be found at www.shareholdervoting.com.

If you would like to discuss this comment letter, please contact me at 416-863-5592 or chansell@dwpv.com or Lisa Damiani at 416-367-6905 or ldamiani@dwpv.com.

Yours very truly,



Carol Hansell

CH/tl