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VIA E-MAIL AND COURIER

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

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Re: Consultation Paper 25-401 Potential Regulation of Proxy Advisory Firms

Dear Sirs:

We are pleased to respond to your request for consultation with respect to the potential regulation of proxy advisory firms.

Our national law firm represents a large number of public company issuers, of varying size, industry sector and principal provincial jurisdiction.

We are extensively involved in assisting issuers in preparing disclosure contained in proxy management circulars, and providing advice on matters forming the subject matter of such meetings.

We are also extensively involved in assisting and advising issuers on corporate governance requirements and practices.

We also have an extensive public company M&A practice. Our deal studies (the Blakes Public M&A Deal Study) done over the past five years shows that most significant M&A transactions in Canada are effected through a plan of arrangement, which require a shareholder vote.

Our response is focused with respect to the matters we have experience with arising out of our practice on behalf of issuers.

Legal Framework

However, before responding to certain of the specific questions raised by your Consultation Paper, we believe it is important to put in context the rationale for a consideration of any potential regulation of proxy advisors in the context of securities legislation. The *Securities Act* (Ontario) (the "Act") in Section 1.1 provides that the purposes of the Act are (a) to provide protection to investors from unfair, improper or fraudulent practices; and (b) to foster fair and efficient capital markets and confidence in capital markets. The primary means for achieving the purposes of the Act are set out in Section 2.1 of the Act, which include requirements for timely, accurate and efficient disclosure of information and requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants. The legislation of the other Canadian Securities Administrators have similar purposes and provide for similar means.

Whether it is appropriate that there be some form of regulation in respect of proxy advisory firms under securities legislation will turn on whether the regulation of their activities in the Canadian capital markets, including in respect of other market participants, is appropriate in light of the purposes of securities legislation and the means set out to achieve such purposes.

We recognize that the primary relationship of proxy advisors is to their clients and thus the degree and form of any regulatory response should be proportionate and attempt to obtain maximum benefit at the least cost to participants through practical measures.

Potential Inaccuracies and Limited Opportunity for Issuer Engagement

We think it useful, as an evidential matter, to report on our experience in this regard. Our professional obligations preclude citation of specific examples in this public forum; we expect that some of our issuer clients will make submissions directly to the CSA on this point.

However, we can state, based on our years of experience with, and advice to, many issuers, as a factual matter, proxy advisory reports have contained factually inaccurate information. In many cases, these are detected after being introduced into the market place (although sometimes with difficulty by issuers following the issuance of the report) requiring retractions. Often they are discovered when management investigates a significant, and unexpected, "no vote" on some matter, or a "withheld" vote for a director, which turns out to be based on inaccurate information in a proxy advisory report (which information was often correctly provided in the proxy circular).

As well, in our experience, such errors can have a number of significant results. Firstly, inaccurate information is provided to investors regarding the issuer. As well, incorrect information and analysis may lead to inappropriate advice regarding the election of the board of directors as noted above, an important decision. In some cases, recommending a "withhold" vote on a technically incorrect basis has a reputational implication for individuals. Thirdly, it affects other aspects of governance, such as corporation's compensation plans and policies. These matters affect all of the investors in the issuer, not just those who retain the proxy advisory firms.

A company's management proxy circular is regarded as a "core" document under applicable securities legislation for the disclosure of information, evidencing that the disclosure in such proxy circulars is regarded under securities legislation as an important aspect of disclosure regarding issuers. Proxy advisory firms, as professional organizations, provide such disclosure, and analysis of it. For proxy circulars, materiality of disclosure may be determined by whether it would reasonably be expected to have a significant effect on a shareholder's voting decisions. The disclosure and analysis prepared and provided by proxy advisory firms

is for that very purpose. If such reports contain inaccuracies, including misrepresentations, one of the "means" under securities legislation, of timely, accurate and efficient disclosure of information, is thwarted.

This suggests that measures in some form designed to minimize the chances of misrepresentations regarding a reporting issuer in a proxy advisory report is appropriate.

Security regulators have also, primarily through the means of disclosure, attempted to promote awareness of corporate governance practices, pursuant to National Instrument 58-101 Disclosure of Corporate Governance Practices and related Corporate Governance Guidelines contained in National Policy 58-201. Disclosure of such practices is apparently of important concern to Canada Securities Administrators in fulfilling the purposes of the securities legislation. Apart from simply providing information and disclosure, it is evident proxy advisory firms are playing a more and more prominent role with respect to corporate governance practices, assessing these in relation to voting recommendations as to directors, important matters such as compensation plans and "say on pay" votes on compensation.

As well, proxy advisory firms provide services as to advice on substantive corporate decisions, being the election of directors, appointment of auditors, equity based compensation plans and compensation policies and practices through "say on pay" votes, and M&A transactions. These decisions, which have economic consequences, are of significant relevance to issuers and thus all investors in those companies.

The directors are legally obligated under corporate law to supervise the management of the corporation – the most significant decision made by shareholders relates to the election of directors.

In addition to required corporate shareholder votes for arrangements, securities legislation itself requires in certain circumstances additional voting requirements for M&A transactions, such as under MI 61-101 Protection of Minority Security Holders in Special Transactions.

Accordingly, with a view to ensuring, so far as possible that, disclosure, and the analysis of disclosure, regarding reporting issuers is as accurate as possible, both for its own sake as regards accurate disclosure regarding the issuer, but also in regard to disclosure that may affect aspects of corporate governance such as the election of directors, M&A transactions and compensation matters (and thus affect, perhaps materially, other investors), consideration should be given to address in some manner codification of the prior review by issuers of draft reports and consideration of corrections, as a fairly non-intrusive method of

improving disclosure. We understand that the proxy firms and their institutional investor clients believe this is usually done in any event, so a recognition of "regularization" of that may not be overly intrusive given the benefits of enhanced accuracy in disclosure.

Corporate Governance Implications

The Consultation Paper raises as a potential concern perceived corporate governance implications, being that proxy advisory firms may have become *de facto* corporate governance standards setters. As a matter of our experience, we can attest to the fact that issuers in many cases seek to understand the criteria used by proxy advisory services in formulating policies or practices which relate to matters that will be subject to shareholder approval – which includes corporate governance practices generally, as these are used for determining director election votes.

However, we recognize that the shareholders who utilize proxy advisory services, as a matter of corporate law, as between themselves, the corporation and other shareholders, typically have the right to vote their shares on whatever basis they wish. (We recognize that the obligations of the institutional investors to their own clients may impose other standards). This being the case, the role for others in the formulation of these policies is legitimately limited. Having said that, there is likely a useful role for consultation with other market participants, such as reporting issuers, regarding voting guidelines, so that, in developing policies which will ultimately guide votes of the shareholders who contract with proxy advisory services, both the proxy advisors and their clients can be aware of, and take into account as they see fit, issuers' perspectives and input with respect to such policies. Again, while we appreciate that this imposes some additional burden, we think it is minimally intrusive and would provide benefits to all participants.

Conflict of Interest and Lack of Transparency

Our experience has also been that issuers have felt compelled to use the advisory services offered by proxy advisory firms – in some cases, perhaps because they believe (rightly or wrongly) they have to "buy" the recommendation. However, perhaps more realistically, and significantly, given the criteria and models used for compensation plans, this is the only practical way an issuer can determine whether there will be a favourable proxy advisory recommendation, which may be critical to determining levels of possible approval, which in turn is necessary for corporate decision-making as to types of plans, and other matters, to be put

forward to shareholders for approval. This, accordingly, is to buy, not the result, but to buy, in effect, knowledge of the likely outcome as only that proxy advisory service may have the criteria and models needed to determine that information.

Accordingly, the concern regarding "conflict of interest" is of importance not just to the institutional investors who purchase the services of proxy advisory firms. If issuers, as a practical matter, find it appropriate to purchase the service of proxy advisory firms in connection with approval of corporate measures which require shareholder approval (such as compensation plans), shareholders, others than those who have contracted with the proxy advisory firm, are affected. Their funds are used to buy the services. The plans to be adopted by the companies in which they have invested will be shaped by the proxy advisor's report. As well, the type of plans put forward may in whole or in part be shaped by the proxy advisory service's advice to the issuer.

A possible solution to this "conflict" may be found in addressing a related, separate concern identified in the Consultation Paper, that being concerns relating to a lack of transparency on the voting recommendations. For example, it may be useful to consider some codification of practices such that proxy advisory services disclose publicly all of their criteria and policies with sufficient clarity and information that an issuer can reasonably determine what the proxy advisor's recommendation may be, without being required to purchase their services.

If the proxy advisor's clients' goal is that these criteria and policies be adopted by issuers, it would not be expected they would object to the public disclosure of these.

The Consultation Paper suggests that one solution may be for issuers to be subject to a requirement that they disclose in the applicable proxy circular if they have acquired proxy service's advice. If that suggestion were followed, it would follow that the nature of the proxy service's advice or report to the issuer should also be disclosed. We are not certain that this is an appropriate regulatory response to this concern. Firstly, imposing additional requirements on issuers, already subject to significant and extensive disclosure requirements for proxy circulars, would appear to be an inappropriate way of addressing perceived conflict of interest and transparency issues for proxy advisory services. Secondly, providing such disclosure would now become yet another corporate governance practice required to be adopted by issuers.

Extent of Reliance by Institutional Investors

There is in the market place a lack of information regarding the extent of influence of proxy advisory firms over particular issuers, having regard to the extent of influence of a proxy advisory firm over votes relating to an issuer's securities is relevant to an issuer, in making decisions regarding matters to be put forward for shareholder approval. This information may also be relevant to other shareholders. It is arguably relevant information (perhaps positive or negative) to a prospective investor in a company to be aware as to whether a proxy advisory firm provides advice, and thus exercises some influence, over a material portion of the votes of an issuer's securities, and therefore may be a relevant factor for decisions regarding investments in, and continuing to hold investments in, the issuer. Securities legislation requires disclosure in respect of reporting insiders, including those who exercise "control or direction", and not just "ownership" of securities. It is arguable that disclosure of the influence of proxy advisory firms over votes for a given reporting issuer will be as important to the market place and investors as reports of "control or direction".

Accordingly, consideration should be given to disclosure by proxy advisory firm, perhaps by category of types of services (provide "advice", given exclusive authority, given authority minus objection, etc.) as to the percentage of votes of an issuer they influence, without requiring disclosure of their clients, when it reaches a significant level of, for example, 20% or more.

Fitness Aspects

The advice of proxy advisory firms can influence the choice of directors, the choice of auditors, the approval of compensation plans, the approval of compensation policies and practices and approval of public M&A transactions. All of these decisions, affecting the issuer as a whole, all investors, and other stakeholders, raise the question of considering standards for providing advice. Our experience is that decisions concerning directors, compensation policies and obviously M&A transactions, and thus advice concerning them, may be as significant as advice on trading securities. If registration is required for a broker to give advice on buying and selling securities, the argument for addressing the qualifications for those recommending a "for" or "against" vote with respect to a corporate transaction by way of an arrangement which has the same result as a sale, or other corporate decisions affecting value, cannot be completely dismissed.

Whether there should be a regulatory response to address qualifications in some form, and to supervision and similar measures with respect to the advice provided by proxy advisors, is a matter beyond our experience and raises perhaps more significant policy issues than the other matters, which might be addressed by practical responses relating to proxy circulars, policy development and disclosure. We simply note that, given the objectives of and means set out in securities legislation, it is not inappropriate for the CSA to consider addressing this subject area. The form and content of any such regulation is a topic which would require further consultation with proxy advisory firms to achieve some benefit in the least intrusive fashion, while attempting to fulfill the means of the *Securities Act* for the maintenance of the high standards of fitness and business conduct.

To address certain of the questions, following your format, and based on the foregoing, we respond to certain of your questions as follows:

5.3:

1. As described above, we agree with the concerns identified in the Consultation Paper based on our experience as described above. What the Consultation Paper has described as a conflict of interest concern is in our view really, at least in part, a transparency of criteria concern.

2. It is not clear the Consultation Paper raised the potential "fitness" concern expressly.

3. As noted above, we are of the view that the process relating to the content of proxy advisory reports regarding reporting issuers be addressed in some fashion to enhance accurate disclosure regarding issuers. As noted, the most practical route for this that we see is an opportunity for issuers to review draft proxy advisory reports. We also think there should be greater transparency of criteria so issuers do not have to purchase the services of the firm to determine the likely recommendation on a proposal requiring shareholder approval.

4. As noted above, yes, as indicated above by addressing in some form enhanced accurate disclosure in proxy advisory reports, transparency as to the criteria used sufficient to allow issuers to ascertain whether matters proposed by them will receive a positive recommendation, allowing for some issuer involvement in policy development, and considering disclosure of the extent of influence.

5. Whether or not proxy advisory firms are subject to conflicts of interest, as noted above, it appears to be inappropriate to us that issuers as a practical matter believe it necessary to buy the services of one branch of a proxy advisory firm to ascertain what the recommendation of the other branch of the proxy firm to its clients will likely be, if the information to make that determination is not otherwise available.

7. No.

9. As noted above, we think prior issuer review of draft proxy advisory reports would be appropriate, as a hopefully practical step aimed at improving accuracy of disclosure.

10. As noted above, we believe that it is appropriate for proxy advisory firms to engage with issuers in all circumstances, if the proxy advisory firms are providing disclosure regarding such reporting issuers. Some issuers may choose not to engage.

11. As noted above, our response is issuers should be provided with an opportunity to review reports in all circumstances.

12. We think this would simply be a matter of codifying in some form an opportunity for issuers to review, and comment.

13. As noted above, it may be of benefit to all to codify in some fashion some degree of issuer involvement in policy development.

14. Yes, as to the matters outlined above, without a strong recommendation as to form.

16. Your proposal for a separate regulatory instrument appears reasonable.

17. As indicated above, we have made suggestions for consideration as to these areas where some form of regulation could be appropriate in fulfilling the purposes of securities legislation.

Yours very truly,

John M. Tuzyk

JMT/mtp