March 30, 2011

John Stevenson, Secretary
Ontario Securities Commission
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Re: **Request for Comments – OSC Staff Notice 54-701: Regulatory Developments Regarding Shareholder Democracy Issues**

Dear Mr. Stevenson:

We are writing in response to the Ontario Securities Commission (OSC) request for comments on Staff Notice 54-701 *Regulatory Developments Regarding Shareholder Democracy Issues*[1]. NEI Investments commends the OSC for its continuing efforts to enhance corporate governance in Canada, and for seeking stakeholder input.

With over $4.9 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will provide higher risk-adjusted returns over the long term. Through our company evaluations, our active engagement with companies in our funds, and our issues research, we have developed considerable insight into good practices and weaknesses in corporate governance and shareholder democracy provisions, which we endeavour to share in the context of consultations on public policy and standards.

In the following pages we set out our comments and recommendations on the issues raised by the OSC, as well as other issues related to shareholder democracy. We encourage the OSC to take action on these issues, and to promote action by the Canadian Securities Administrators (CSA), to ensure that Canada does not lag behind other jurisdictions.

Slate voting and majority voting for uncontested director elections

We strongly recommend that the OSC mandate annual election of individual director nominees under a majority voting system. These good practices are not only fundamental to shareholder democracy, but they have been widely adopted by Canadian issuers without disrupting business.

[1] **Ontario Securities Commission.** Staff Notice 54-701: Regulatory Developments Regarding Shareholder Democracy Issues. [Online] 2011. http://www.osc.gov.on.ca/en/NewsEvents_nr_20110110_osc-reg-proposal.htm

A minority of TSX Composite companies continue to practice slate voting, in which shareholders must vote on the entire slate of director nominees presented by management. This obstructs shareholders from voting against individual directors for performance issues such as poor board attendance or poor decision-making on a specific board committee. The only option in such cases is to vote against the whole board, or conduct a costly proxy fight. Shareholder interests would be best served by ending slate voting and mandating that voting on director candidates should be conducted on an individual basis.

Under the plurality voting system, whereby "withhold" votes are discounted, directors can be elected without receiving a majority of shareholder votes – indeed, a single vote in favour of a director nominee is all that is required for election. Where director nominees are also shareholders, they can be elected on the basis of their own votes. Once again, this prevents shareholders from voting against specific under-performing directors. We believe shareholder interests would be best served by mandating a majority voting system in which director nominees would require the support of the majority of votes cast to be elected.

Majority voting has become a voluntary norm among major Canadian issuers, with many companies adopting at least the requirement that directors should offer their resignation if they do not receive a majority of votes in favour of their election or re-election. According to research by the Canadian Coalition for Good Governance (CCGG), more than half of S&P/TSX Composite issuers – 75% by market capitalization – had adopted a majority voting policy as of December 2010[2].

Mandated shareholder advisory votes on executive compensation

Compensation is a key driver for corporate behaviour: inevitably, the attitude of management and employees toward risk will be influenced by the way they are rewarded. Appropriate compensation frameworks incentivize effective risk management and help to build long-term sustainable value.

We believe that mandating the advisory vote on executive compensation – "say on pay" – would be in the interests of shareholders. Say on pay gives shareholders a targeted way to provide feedback to companies on the crucial issue of compensation policy and practice. Without it, we can only express dissent by withholding support from one or more of the directors who serve on the compensation committee. This is problematic if we view these directors as otherwise valuable to the board. We prefer a mechanism that allows us to send a direct message about the specific topic of executive compensation. As most boards make compensation decisions annually, we believe that say on pay votes should also be conducted annually.

Where it is available, the executive compensation vote encourages companies to establish more accountable and responsible remuneration practices, and to improve pay disclosure. As outlined in the OSC Staff Notice, a number of jurisdictions have already mandated say on pay. A 2009 report[3] chronicling six years of experience in the U.K. found that the benefits of offering shareholders an advisory vote on executive compensation included enhanced dialogue with shareholders, better disclosure, and more attention for corporate governance in general. An increasing number of Canadian companies are providing say on pay on a voluntary basis. Since February 2009, 47 Canadian issuers have agreed to provide an annual advisory vote on executive compensation; 29 of them held their first votes in 2010. Compensation votes have not proven to be disruptive, and we have observed progress in compensation disclosure at companies that have adopted the practice, although there is still much room for improvement.

[2] **Canadian Coalition for Good Governance.** Majority Voting Policy. [Online] 2011. http://www.ccgg.ca/site/ccgg/assets/pdf/Majority_Voting_March_10_2011.pdf. This document also provides a suggested form of majority voting policy.

[3] **Railpen Investments and PIRC Limited.** Say on Pay: Six Years On. [Online] 2009. http://www.rpmi.co.uk/uploads/pdf/Say_on_Pay_six_Years_on.pdf

Say on pay is a logical accompaniment to enhancing executive compensation disclosure requirements. We recognize the continuing efforts of the OSC and the CSA to enhance standards in this area, enabling shareholders to make increasingly effective use of say on pay where it is offered. A company that explains its compensation philosophy and metrics clearly, links pay to performance in a reasonable way, and communicates effectively with investors, will likely find say on pay to be a useful engagement tool.

Through our corporate engagement and public policy activities, we have been promoting say on pay for the past several years. In 2007 we wrote to every company on the TSX Composite Index, asking them to provide shareholders with the opportunity to express their opinion on compensation. We have co-filed a series of shareholder resolutions requesting adoption of say on pay, as well as supporting similar resolutions filed by other shareholders. As members of CCGG, we welcomed the incorporation of say on pay into the coalition's recommended good practices in 2010[4].

We recommend that shareholders should also be offered an advisory vote on "golden parachute" payments resulting from mergers and acquisitions. In some instances, these payments have been unconscionably excessive. We suggest, therefore, that in addition to offering a vote, regulatory principles governing golden parachutes could be established, to ensure that corporate executives do not enrich themselves at the expense of shareholders. Under our proxy voting guidelines, we vote against golden parachutes unless management can demonstrate that the arrangements are in shareholders' long-term interest, that they do not create a conflict of interest for recipients, and that the amounts involved are reasonable compared to similar benefits for all employees of the company. We also vote against golden parachutes that are not contingent on a change in the ownership of more than 50% of the company[5].

Effectiveness of the proxy voting system

There is much debate over the quality and effectiveness of the proxy voting system, not only in Canada but internationally. We welcome the OSC's recognition of the need for improvement in this area.

One aspect of ensuring effectiveness of the proxy voting system is that shareholders should take proxy voting seriously. We endorse the position in CCGG's Principles for Governance Monitoring, Voting and Shareholder Engagement:

"Institutional investors generally should vote all the shares they own in a company where it is in the best interests of their beneficiaries or clients to do so. Institutional investors should use their best efforts to ensure that their voting decisions are made in light of the particular circumstances of each company and should avoid a 'check the box' approach. Accordingly, institutional investors should not automatically support management or directors and should cast their votes only after carefully considering all relevant information. If an institutional investor uses outside service providers to assist it in arriving at its voting decisions, the institutional investor should assess the advice it receives rather than automatically following it."[6]

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[4] **Canadian Coalition for Good Governance.** Model Shareholder Engagement and "Say on Pay" Policy for Boards of Directors. [Online] 2010. http://www.ccgg.ca/site/ccgg/assets/pdf/CCGG-Say-on-Pay-Final.pdf. This document also provides a suggested form of resolution for an advisory say on pay vote.

[5] **NEI Investments.** Proxy Voting Guidelines. [Online] 2010. http://www.neiinvestments.com/NEIFiles/PDFs/5.2.3%20Proxy%20Voting/5.2.3%20Proxy%20Voting%20proxy_voting_guidelines.pdf

[6] **Canadian Coalition for Good Governance.** Principles for Governance Monitoring, Voting and Shareholder Engagement. [Online 2010]. http://www.ccgg.ca/site/ccgg/assets/pdf/Principles_for_Governance_Monitoring_Voting_and_Shareholder_Engagement-Formatted__2_.pdf

At NEI Investments, wherever we are legally permitted to do so, we vote every one of our proxies according to a detailed set of proxy voting guidelines that are updated regularly and are publicly available[7]. While we use a proxy advisory firm, two in-house staff members are responsible for analyzing and executing every vote. We also make it a policy not to engage in securities lending, as this can affect our ability to vote on important issues on behalf of our unit holders.

A recent discussion paper, *The Quality of the Shareholder Vote in Canada*[8], highlighted several challenges and gaps in the current proxy voting system. We agree with the authors that in an effective proxy voting system, investors would be enabled to make informed voting decisions; votes would be exercised only by investors who have the right to do so; votes would be executed and counted correctly; results would be reported promptly; and the system would be transparent enough to inspire confidence in stakeholders. In particular, we were struck by the troubling observation that there was not enough information available either to confirm that problems exist, or to provide assurance that they do not. Given this knowledge gap, we would support the suggestion made in the paper that a comprehensive audit of the proxy voting system be undertaken by a taskforce of subject matter experts. Before making drastic changes to a system that may or may not be broken, it would be advisable to establish the current state of the system. OSC could play an important convening role in this activity.

Even before such an audit, regulators could review one of the tenets giving rise to complications in the proxy voting system. Under Canadian securities law an investor may claim Objecting Beneficial Owner (OBO) status, with the result that the investor's identity is not disclosed to the issuer. About half of Canadian investors are OBOs. It is hard to see how OBO anonymity contributes to the transparency that should be a key feature of a well-functioning proxy voting system, nor to investors exercising their full rights and responsibilities as owners of public companies. As noted in the discussion paper mentioned earlier, in jurisdictions other than the U.S. and Canada, issuers are permitted to communicate directly with all their shareholders.

Proxy voting disclosure is another transparency concern that demands attention. As a mutual fund manufacturer, NEI Investments is required under the provisions of National Instrument 81-106[9] to disclose its proxy voting activity. We strongly support these provisions: indeed, we began to provide proxy voting disclosure for our Ethical Funds family long before it was compulsory to do so, in the belief that our unit holders had the right to know how we were voting on their behalf, and why. While recognizing that this matter may not fall under the jurisdiction of securities regulators, we continue to question why other institutional shareholders, such as pension funds, endowments and foundations, are not subject to the same proxy voting disclosure requirements as mutual funds.

Other issues

Engaging effectively with shareholders: revisiting "Principle 9"

In 2008 the CSA released for comment a set of draft Corporate Governance releases[10]. In our response[11] to the proposals, we welcomed the idea of broadening the scope of policy to encompass several new areas – including effective

[7] **NEI Investments.** Proxy Voting Guidelines. [Online] 2010. http://www.neiinvestments.com/NEIFiles/PDFs/5.2.3%20Proxy%20Voting/5.2.3%20Proxy%20Voting%20proxy_voting_guidelines.pdf

[8] **Davies Ward Phillips & Vineberg LLP.** The Quality of the Shareholder Vote in Canada. [Online] 2010. http://www.dwpv.com/shareholdervoting/

[9] **Canadian Securities Administrators.** National Instrument 81-106 and Companion Policy 81-106CP - Investment Fund Continuous Disclosure, and Form 81-106F1. [Online] 2010. http://www.osc.gov.on.ca/en/13058.htm

[10] **Canadian Securities Administrators.** Request for Comment – Proposed Repeal and Replacement of NP 58-201 Corporate Governance Guidelines, NI 58-101 Disclosure of Corporate Governance Practices, and NI 52-110 Audit Committees and Companion Policy 52-110CP Audit Committees. [Online] 2008. http://www.osc.gov.on.ca/documents/en/Securities-Category5/rule_20081219_58-201_rfc.pdf

engagement by corporations with their shareholders and other stakeholders ("Principle 9"). We suggest that OSC might revisit this aspect of the 2009 releases in the context of its shareholder democracy deliberations.

As explained in our 2009 response, although we saw Principle 9 as a good starting point, we felt it did not reflect the full scope of effective engagement with shareholders, because it addressed only one element – shareholder voting at the Annual General Meeting (AGM). While filing and voting on resolutions are cornerstones of shareholder rights, they also represent the last resort in terms of exercising shareholder voice. Effective engagement should also encompass issuer interaction with shareholders before the AGM and throughout the year.

Promoting effective shareholder representation: board diversity

It is fundamental to shareholder democracy that investors should have the right to vote for or against individual director candidates, and that the proxy voting system should ensure that the votes are executed and counted correctly. But good election practices can only contribute to the long-term sustainable value of companies if the director candidates nominated encompass the full range of skills, abilities and experience that will allow them to exercise sound oversight and decision-making. Companies face diverse challenges, not only in the financial sphere but also in the environmental and social spheres. As recognized by CCGG in its best practice guidelines *Building High Performance Boards*[12], boards that contain a diversity of knowledge, experience and viewpoint are likely to be better equipped to foresee, and develop strategy to address, these risks and opportunities.

Various studies[13] have demonstrated a positive correlation between the presence of women on the board, and company value. Yet gender diversity at the board level is lacking in Canada, and change has been painfully slow. In 2009, only 9% of directors at Canada's 300 largest public companies were female, and 49% of these boards had no women directors[14].

Other jurisdictions are already taking steps to address aspects of the board diversity issue. In 2009 the U.S. Securities and Exchange Commission (SEC) implemented a new rule[15] that included provisions on diversity policy. Companies are now required to disclose if and how diversity is considered in nomination of candidates to the board, and how the company assesses the effectiveness of its diversity policy. Similar disclosure requirements have been established in Australia[16]. Some countries have legislated quotas for women on the board, including Norway, Spain, France, Italy and Sweden. Similar requirements are being debated in Belgium, Germany and the Netherlands. In Canada, Senate Bill S-238 has proposed a 50% quota of female directors for a wide range of public and other corporations, with a three-year timeline for achievement.

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[11] **NEI Investments.** Canadian Securities Administrators: Corporate Governance Policy and Disclosure. [Online] 2009. http://www.neiinvestments.com/neifiles/PDFs/5.5%20Public%20Policy%20and%20Standards/NEI%20-%20CSA%20Corporate%20Governance%20-%20final.pdf

[12] **Canadian Coalition for Good Governance.** Building High Performance Boards. [Online] 2010. http://www.ccgg.ca/site/ccgg/assets/pdf/CCGG_Building_High_Performance_Boards_Final_March_2010.pdf

[13] See, for example: **Rhode, Deborah and Packel, Amanda.** Diversity on Corporate Boards: How Much Difference Does Difference Make? [Online] 2009. http://ssrn.com/abstract=1685615; **Carter, Nancy and Wagner, Harvey.** The Bottom Line: Corporate Performance and Women's Representation on Boards (2004–2008). [Online] 2011. http://www.catalyst.org/file/445/the_bottom_line_corporate_performance_and_women's_representation_on_boards_(2004-2008).pdf

[14] **WomenOnBoard Mentoring Program.** Why We Created the Program. [Online] 2010. http://www.womenonboard.ca/Programs/WhyCreatedProgram.asp

[15] **Securities and Exchange Commission.** 17 CFR Parts 229, 239, 240, 249 and 274 [Release Nos. 33-9089; 34-61175; IC-29092; File No. S7-13-09] RIN 3235-AK28 Proxy Disclosure Enhancements. [Online] 2009. http://sec.gov/rules/final/2009/33-9089.pdf

[16] **ASX Corporate Governance Council.** Corporate Governance Principles and Recommendations with 2010 Amendments. [Online] 2010. http://www.asx.com.au/documents/about/cg_principles_recommendations_with_2010_amendments.pdf

While the benefits and drawbacks of specific gender quotas are widely debated in Canada, other provisions could also be considered that could not only encourage diversity, but also improve the quality of boards all round. One critical issue is the tendency of boards to seek director candidates among their own circles – which can mean "more of the same", and lead to boards that lack the full range of relevant skills and experience. We believe that policy guidance and disclosure provisions that stimulated companies to professionalize the recruitment of director candidates, and make the recruitment process more transparent to shareholders, could lead to greater diversity by expanding the pool of individuals considered as candidates.

In order to derive the benefits of diversity, there must be "diversity within the diversity" - it should not always be the same few women that sit on every board. With any director candidate, if the individual holds many directorships, it creates concern as to whether he or she can devote adequate time to board duties, and reduces the potential for diversity of thinking across companies.

Conclusion

We commend the OSC for opening this consultation on shareholder democracy issues. We strongly recommend that the OSC take steps to end slate voting and incorporate majority voting and the advisory vote on executive compensation into securities regulation in Ontario. We also recommend that the OSC should promote the incorporation of these fundamental shareholder rights into securities regulation in the other Canadian jurisdictions through CSA. We note that the OSC could play a valuable convening role in auditing the proxy voting system. Finally, we suggest that both board diversity and the overall quality of board candidates would be served by provisions that encourage a more transparent and professional selection process for board candidates.

Should you have any questions with regard to this submission, please do not hesitate to contact Michelle de Cordova, Manager, Public Policy & Research (mdecordova@NEIinvestments.com, 604-742-8319).

Sincerely,

NEI Investments

John Kearns
Chief Executive Officer

Robert Walker
Vice President, ESG Services

CC: Board of Directors, NEI Investments