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John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
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Dear Mr. Stevenson

Re: OSC Staff Notice 54-701 – Regulatory Developments Regarding Shareholder Democracy Issues

Thank you for the opportunity to provide comment on Staff Notice 54-701 on Shareholder Democracy Issues ("Notice 54-701"). My responses are restricted to the issue of the effectiveness of the proxy voting system.

The commitment of the Ontario Securities Commission (the Commission) in its 2010-2011 Statement of Priorities to review protections for shareholders' rights and corporate governance is to be applauded. Also, I strongly endorse the statement in the Notice whereby Commission staff "recognize the need for an effective proxy voting system that allows shareholders to make informed voting decisions and ensures that their votes are counted at shareholder meetings."

INTRODUCTION

There is no system in place that works so well that it does not bear examination to determine whether it can be improved. The proxy voting system in Canada is no exception. From my perspective, the threshold issue is whether there is sufficient reason to devote the Commission's limited resources to the review, given the other pressing demands on its attention. Many of the issues that have been flagged lately as significant problems are ones that are not new. Some, such as securities lending and the potential for over-voting, have been discussed for years. No practical solution has been identified where the benefit of the changes required outweighed the costs and collateral effects on other aspects of the market.

Further, the assessment of the issues that some commentators have identified as being 'of concern' and the decision as to whether they warrant detailed review may well depend on the perspective from which the analysis is conducted and the assumptions underlying that analysis. It is easy to get lost in the rhetoric and lose sight of the goals of the processes under review and their functioning in practice. If the Commission is going to assess the need for a wide-ranging regulatory review of the proxy voting system, then I believe

that that analysis must begin with the fundamental underpinnings of securities regulation – first principles, if you will – the purposes securities legislation is supposed to fulfill.

Section 1.1 of the Securities Act says that the –

> "purposes of this 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."

Translating this to the issues at hand means that any review of the proxy process must be investor-centric. The Commission should begin from the perspective of the rights and interests of shareholders in the proxy process while at the same time bearing in mind the need for the process to be efficient. The "rights", if any, of the other parties in the process – the issuers and intermediaries – should be subordinated to those of investors.

INVESTORS' RIGHTS

Rights to Equitable Treatment, Information and to Vote. The Financial Stability Board has recognized a number of economic and financial standards that are internationally accepted as important for sound, stable and well functioning financial systems.[1] Among these are the Principles of Corporate Governance[2], established by the Organisation for Economic Co-operation and Development (OECD Principles), and the Objectives and Principles of Securities Regulation, published by the International Organization of Securities Commissions (IOSCO Principles).[3] These standards clearly state that shareholders holding voting shares should have the same basic rights, *inter alia*, to:

- obtain relevant and material information on the corporation on a timely and regular basis;
- participate effectively and vote in general shareholder meetings, including being furnished with full and timely information regarding the issues to be decided at the meeting; and
- elect and remove members of the board.[4]

The OECD Principles state that the corporate governance framework should ensure the equitable treatment of all shareholders, whether they are minority, domestic or foreign. All shareholders of the same series of a class should be treated equally, with all shares of the same class carrying the same rights, and votes should be cast by custodians or nominees in a manner agreed upon with the beneficial owner of the shares.[5] Interestingly enough, while the OECD Principles are explicit about shareholders' rights, they say nothing about an issuer's right to know all its shareholders.

These principles underpin the rules regarding shareholder communication and the proxy process in Canadian law. Where the corporate law has not kept pace with market practices[6], the securities regulators have acted to address the gaps via the provisions of instruments such as National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* (NI 54-101) and National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102).

For example, corporate law focuses on registered holders of the company's securities. It rarely acknowledges the existence or rights of beneficial owners. Continuous disclosure and shareholder

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1 The compendium of these standards can be found at: http://www.financialstabilityboard.org/cos/key_standards.htm.

2 http://www.oecd.org/dataoecd/32/18/31557724.pdf.

3 http://www.iosco.org/library/pubdocs/pdf/IOSCOPD329.pdf.

4 See OECD, Principles II A and C and IOSCO, Principle 15.

5 See OECD, Principle III A.

6 Such as the majority of shares being held through intermediaries or the emergence of issuers structured other than as corporations.

meeting information was not going to the growing number of shareholders and their rights to participate in the shareholder democratic process therefore were impaired. In 1987, the Canadian Securities Administrators (CSA) stepped in to redress these gaps by creating a process for communication with beneficial owners, requiring issuers to provide proxy related materials to these investors and imposing obligations on intermediaries to forward the materials and vote in accordance with the instructions of their clients. One of the stated goals of National Policy Statement 41 *Shareholder Communication* (NP 41) was to "ensure that non-registered holders have the same access to corporate information and voting rights as registered holders." NP 41 was replaced by NI 54-101 in 2002.

Right to Privacy. The law in Canada generally recognizes that all persons have the right to control access to their personal and proprietary information. Privacy legislation, such as the *Personal Information Protection and Electronic Documents Act*[7], restricts the ability of entities to collect information about persons and to use or disclose that information without consent. Common law duties of confidentiality on certain intermediaries, limit the ability of those entities to disclose information about their clients to anyone without the client's consent. NP 41 expressly recognized the right of shareholders to remain anonymous even before the emergence of privacy statutes. The right to remain anonymous continues in NI 54-101.

The right to control disclosure of a person's personal and proprietary information is not unqualified and can be overruled by express provisions in the law. This has been done in circumstances where the public policy interest in disclosure has been judged more important than maintaining the particular person's privacy. Three examples come to mind.

1. Securities legislation in Canada and many other jurisdictions require investors with material interests in a reporting issuer to make prompt disclosure of those positions and any material changes in that ownership (insider reporting rules and early warning reports).
2. The portfolio holdings of investors are generally considered private information. An exception is made for public mutual funds. National Instrument 81-106 *Investment Funds Continuous Disclosure* (NI 81-106) requires these mutual funds to make quarterly public disclosure of their top 25 investment holdings (among other information).
3. The voting policies and voting decisions of investors generally are not required to be made public, although advocates of good governance encourage institutional investors to make such disclosure. However, NI 81-106 requires public mutual funds to disclose their proxy voting records at least annually. The rationale for that requirement is set out in the companion policy to that instrument at section 6.1(2):

   > Because of the substantial institutional voting power held by investment funds, the increasing importance of the exercise of that power to securityholders, and the potential for conflicts of interest with respect to the exercise of proxy voting, we believe that investment funds should disclose their proxy voting policies and procedures, and should make their actual proxy voting records available to securityholders.

Legislators and regulators need to balance the public's right to know against investors' rights to keep proprietary information private. Any decision to abrogate privacy rights to support public policy objectives should infringe on those rights no more than is absolutely necessary. This balance is seen in the example of disclosure of mutual fund investment portfolios above. The right of investors in a mutual fund to know what the mutual fund holds was judged to outweigh the mutual fund's interest in not disclosing proprietary information about its investment strategy. However, the risk that this disclosure would permit free riding on the mutual fund's investment decisions was mitigated by giving a 60 day period before disclosure was required.

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[7] S.C. 2000, c. 5.

Increasing issuer engagement with shareholders does **not** require abrogating all shareholders' privacy rights. Shareholders who wish to engage directly with a reporting issuer have no difficulty in establishing their share ownership. The interest of third parties in access to such information for their own purposes should have a very limited role to play in the public policy assessment.

COMMENTS ON THE EXISTING SYSTEM

Unequal treatment of beneficial owners. In my view, the single largest problem with the existing system governing the proxy system in Canada is the fact that NI 54-101 is silent on who is required to pay for delivery of proxy-related materials to objecting beneficial owners (OBOs)[8]. Issuers are required to pay for delivery to Non-objecting beneficial owners (NOBOs). The obligation to pay for OBOs does not automatically fall on the intermediaries as the statutes in several provinces say the intermediary has no obligation to forward proxy-related materials to investors unless its costs are paid by either the issuer or the investors. Requiring investors to pay directly fails to meet regulatory objectives on two counts: (a) it does not treat shareholders equally; and (b) it would be extremely inefficient to require each beneficial owner to pay directly for each package of proxy-related materials received as the administration cost of billing and collecting these costs would be prohibitive.

If either the issuer or the beneficial owner's intermediary does not agree to pay, the beneficial owner will not receive materials and likely will be disenfranchised. According to the service provider that acts for most of the intermediaries in the NI 54-101 process, 51% of all beneficial owners in Canada are OBOs and the proportion has been growing since the introduction of NI 54-101.[9] As most institutional investors are OBOs, a much higher percentage of shares are held by OBOs than NOBOs. However, a retail OBO is more likely to be disenfranchised than an institutional investor as the latter's custodian or intermediary is likely to either absorb the cost of delivery or build it into the services provided.

The disenfranchisement of shareholders is wrong on policy grounds in several ways.

- It treats shareholders differently, contrary to the OECD Principles and the fundamental principles set out in NI 54-101, for reasons that have not been clearly justified on policy grounds.
- The result penalizes retail investors who are least able to protect themselves.
- It results in extra costs for all parties, such as advice from counsel and other administrative costs in deciding whether or not to pay voluntarily (for each issuer, intermediary and meeting), dealing with questions from investors who have not received materials but want to vote, etc.

The choice whether or not to pay for delivery of materials to OBOs also may have significant corporate governance implications. It is not merely a cost or disclosure issue. In my experience, many issuers do not understand that if they choose not to pay for delivery to OBOs, these investors may not get materials at all and may be disenfranchised. It is also possible that some other issuers make this decision in the hope of influencing the results of the meeting by reducing shareholder participation by particular groups. Neither of these situations supports good corporate governance in the marketplace. In any event, the overall corporate governance system bears the costs from the loss of full shareholder participation in the shareholder democratic process.

In my view, the obligation to pay for delivery of proxy related materials to all beneficial owners should be stated unambiguously in NI 54-101. I do not have a view as to who should bear that cost, other than it should not fall directly on the shareholders concerned. However, addressing this particular gap in our

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[8] OBOs are those beneficial owners who have not given permission to their intermediaries to disclose the investors' names to issuers or third parties.

[9] Comment letter to the CSA from Broadridge Investor Communications Corporation in response to the 2010 publication of proposed amendments to National Instrument 54-101, dated August 31, 2010.

system would not require a complete review of the proxy system in Canada. It could be fixed as part of the current review of NI 54-101.

Communication with shareholders. Since the early days of NP 41, issuers have said they wanted to be able to access the full list of beneficial owners so that they could communicate with their shareholders directly. At the present time, there are two ways that issuers may use to communicate with their shareholders. They may send materials directly to registered holders and to NOBOs or they may send materials out to all beneficial owners through their intermediaries using the indirect process of NI 54-101. When NP 41 was reformulated as NI 54-101, a process was put in place to facilitate access to the list of NOBOs for both delivery of proxy related materials and for other shareholder communication purposes – both by the issuers and third parties. Access to NOBO lists is also permitted under the rules in United States for non-proxy related communication. As I understand it, there are very few requests made for NOBO lists outside the meeting context. I am a retail investor who holds securities both in registered form and through several intermediaries. As a registered security holder of several public companies in Canada, I do not believe I have ever received anything from one of those issuers that was not required to be sent to me by law. My experience as a retail NOBO is similar and leads me to question the stated rationale for access to the full list of investors.

As I understand it, the unstated reason behind the drive for full disclosure is so that issuers and their service providers are able to identify and communicate with holders of large positions in the issuer's securities and to track the build up or decline of those positions. Assuming that public policy supports this aim, a far simpler solution would be to lower the ownership threshold for insider reporting purposes from 10%. This would have the collateral benefits of providing more information to the public on institutional investment assessments of particular issuers and facilitating discussion and action among institutional investors. I understand that this idea is under active review by the Commission and I would encourage it as a much more targeted and balanced solution than wholesale abrogation of shareholders' rights to privacy and the imposition of the costs of an extensive revamp of the current shareholder communication process.

If beneficial owners are going to be required to choose between two rights – the right to control disclosure of their financial affairs and their right to participate in the shareholder democratic process on the same basis as all other shareholders – that choice should only be imposed after a full discussion of the relevant public policy issues and an explicit decision made by legislators or regulators that forcing such a choice is warranted.

Policy objectives and requirements may need to be brought back into alignment. It is not unexpected that the original policy rationale for a particular set of requirements gets muted with the passage of time or that, with multiple overlapping rules, the requirements take inconsistent approaches to similar issues. Further, compromises for the sake of consensus or to address a particular complaint without a strong and clearly articulated overarching policy rationale can make the rules even more inconsistent. For example, both NI 51-102 and NI 54-101 deal with issuers' obligations to communicate with shareholders. Each was formulated at a different time. Both have been amended (or are proposed to be amended) with a view to reducing costs to issuers. But they take very different approaches to who bears the cost of delivery of shareholder communication materials. NI 51-102 requires issuers to ask their securityholders if they want annual and interim financial statements and the related Management Discussion and Analysis documents. Issuers are required to pay for delivery of this financial information to any investor who indicates that they want the materials, without regard to that investor's registered or beneficial owner status and it does not require the shareholders to give up their anonymity. However, under NI 54-101, issuers are not required to pay for delivery of the NI 51-102 request form to OBOs or pay for delivery of proxy related materials to these investors. Also, the CSA has put in place policies and requirements that promote good corporate governance by encouraging active participation in shareholder democracy by investors (such as the requirements for voting and voting disclosure by mutual funds noted above) but at the same time do not require the material necessary for the informed exercise of the vote to

go to all interested shareholders. Bringing the policy goals and requirements back into alignment would improve the system.

The effectiveness of the current system must be acknowledged. Since the introduction of NP 41, the demands on the delivery system have increased substantially. Changes to the CSA rules have increased the choices available to issuers and investors. As a result, the systems necessary to ensure compliance with the rules and stakeholder preferences have had to become progressively more complicated. According to the primary service provider, under NP 41 –

> there were 48 possible combinations of meeting types, shareholder selection, NOBO/OBO status, and language of communication. NI 54-101 increased this to 2,592 alternatives.[10] The additional choices proposed in ... [the 2010 proposed amendments to] NI 54-101 at minimum would increase the alternatives to more than 10,000.[11]

With more complexity comes more opportunity for errors. But in reality, very few errors occur. Materials are delivered to millions of shareholders on time, proxies and voting instructions are returned and thousands of meetings take place without a problem. In addition, technology and new services have enhanced both the efficiency of the delivery process (through processes such as e-delivery) and the exercise of voting instructions (via telephone and internet voting). The cost per package for the indirect delivery process continues to be what it was 24 years ago.

IF A REVIEW IS TO TAKE PLACE

After examining the issues and the comments received on this Notice, if the Commission decides to undertake a review of the proxy voting system in Canada, I would urge the Commission to focus the review on what is needed to:

- protect all investors,
- facilitate their full participation in shareholder democracy,
- meet the expectations of international standards; and
- deliver best on those objectives in an efficient and effective manner.

My other observations are set out below.

The proxy system cannot be examined in isolation. Any proposal to change the proxy voting process must also take into account the other systems that are linked to that process. For example, the proxy voting system is tied into the securities clearance and settlement system under the aegis of CDS Clearing and Depository Services Inc. (CDS). CDS' systems have been developed over many years to clear and settle huge volumes of trades quickly and accurately. Changes to the proxy process likely would require alterations to these systems and these changes would be expensive. It would be imperative that parties with expertise in these related aspects of the market be involved in the review.

The 2010 U.S. Securities and Exchange Commission (SEC) Concept Release on the U.S. Proxy System[12] (Concept Release) raises questions on a wide array of related issues and acknowledges the extensive links between the proxy process and market infrastructure.

Any review must recognize the reality of how shares are held in the global market. The vast majority of equity securities in North America are held in a fungible bulk at central securities

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10 This reflects the addition of choices regarding who is/is not paying for delivery, electronic delivery options, use of NOBO list, etc.

11 Comment letter to the CSA from Broadridge Investor Communications Corporation in response to the 2010 publication of proposed amendments to National Instrument 54-101, dated August 31, 2010.

12 http://www.sec.gov/rules/concept/2010/34-62495.pdf.

depositories. The list of registered holders maintained by or for issuer may only consist of the name of the nominee of the central depository. Most owners hold through intermediaries and institutional and cross-border holdings invariably are indirectly held through custodians. This is true in North America and in most of the rest of the world. The idea of linking a particular voting right with a particular share and a specified shareholder is possible where all beneficial owners are also registered holders, but that is not likely to be feasible at any price in a fungible bulk environment where cross border holdings are common and millions of shares are traded daily.[13] More importantly, it may not be required to achieve the fulfilment of reasonable public policy goals in this area.

The review must also take into account all costs, including the collateral consequences, of fixes. For example, the structure of the securities lending markets and the form of lending agreements leads to a potential for more shares to be voted than there are outstanding. There are a very few recorded cases in Canada of this happening in fact. However, it is a possibility, particularly on a highly publicized contested matter. The possibility could be eliminated by requiring the lender to give up its right to vote the loaned securities during the term of the loan. This seems like a simple solution to the problem. However, the full costs and other consequences of the solution would need to be considered. The loss of voting rights may have capital gains implications, as the transaction may be a deemed disposition under the Income Tax Act. Some institutional investors would cease to participate in the lending market completely, making short selling (which has a positive effect on liquidity and price discovery in the market) more difficult and risky. The ability of market makers to fulfill their valuable role in the market would also be affected. Many of the institutional investors in the lending market have a fiduciary duty to maximize the returns to their beneficiaries. Those who remained in the lending market would have to make a prudent decision each time a meeting was due whether to call the shares back from the loan in order to exercise the votes, or leave the shares on loan. In order to make that decision, they would require information from the issuer on what was to be considered at a given meeting and that information would have to be provided in advance of the record date. In the responses filed with the SEC on the Concept Release, issuers generally have not been in favour of having to make such early disclosure.

There is no easy, 'perfect' solution available from other jurisdictions. Most developed countries are struggling with similar issues as efficiency and safety drive shares into dematerialized form in central depositories, cross-border holdings are more prevalent and trading speeds and volumes are increasing. Many countries have systems that still disenfranchise beneficial owners and operate inefficiently even for registered holders. In several countries in Europe, even voting by proxy was not permitted until recently. The only way to vote was to be a registered holder and appear in person at the shareholder meeting. In my experience there is no jurisdiction that has a solution that gives issuers the names of all their shareholders, gets proxy related information to all investors and lets them exercise their voting rights in an efficient manner. In particular, the limited ability of local rules to bind participants outside the jurisdiction means either that the information does not get to investors or the names of the beneficial owners are not provided to issuers, or both.

Issues relating to improving the proxy process would best be undertaken by combined action by corporate and securities authorities, with input from all market participants. The complexity in the system is increased by the disparate treatment given beneficial owners and registered holders under corporate and securities laws and the differences in delivery requirements (electronic or otherwise) across 14 corporate statutes and 13 sets of securities legislation. It would be of immeasurable benefit to all the participants in the market if the securities regulators would sit down with their colleagues in the corporate branches across the country and develop a common framework in these areas – particularly with respect to the ability of registered holders to opt out of receiving materials and on the requirements applicable to electronic delivery, e.g. notice and access. Like the initiative that resulted in the new securities transfer

[13] Year end data posted on the TMX website disclosed that the TSX and the Venture Exchange together averaged more than 688.4 million shares traded a day in 2010 for a total of 172.5 billion shares in the year.

legislation in many provinces, a coordinated effort led by the CSA is far more likely to produce a common approach than individual discussions with the corporate authorities jurisdiction by jurisdiction.

However, securities regulators have far greater powers to act in a timely and effective manner to address the rights of securityholders in reporting issuers. Harmonized changes across all of the corporate and securities laws likely will have to give way to the practicality of the securities regulators fixing the rules for investors in reporting issuers as best they can and working with the corporate authorities to bring those rules into alignment at the earliest opportunity.

CONCLUDING REMARKS

I have read many of the materials underlying the discussions in the U.S. regarding reform of the proxy system related to the Concept Release. I have participated (for several decades) in similar discussions in Canada in various capacities, including that of regulator, lawyer, employee of an issuer and consultant. I would advise the Commission to approach many of these issues with a great deal of caution. As with many complex areas that impose costs on participants, many people have 'concerns' about how the system works but cannot articulate them precisely. The problems identified and the solutions proposed by interested parties often have more to do with reducing their costs, enhancing their revenues or monitoring shareholder investment sentiment than protecting investors, ensuring full participation in shareholder meetings or enhancing the overall efficiency of the process. In many cases, the fix proposed is facile and/or its cost far outweighs the importance of the problem identified. Some of the issues flagged as being of concern in the proxy process are certainly of academic interest, but I suspect it would be virtually impossible to establish if they were taking place in fact or, even if they are occurring, whether they have a substantive impact on the market. Anecdotes of problems abound, but hard evidence of problems that matter is far more difficult to find. In practice, materials are delivered to millions of shareholders, proxies and voting instructions are returned and thousands of meetings go off without a hitch every year.

The system is not perfect. There is no doubt it can be improved. Do the problems warrant the investment of scarce regulatory and stakeholder time to engage in a wide ranging review of the whole of the proxy process? Ultimately that is a decision for the regulators, but my view would be probably not. Some of these issues have been debated for years in Canada without reaching a consensus. A thoughtful review of the existing requirements to ensure they fulfill the policy objectives of protecting investors and promoting an efficient market, followed by adjustments where misalignments have been revealed, may be sufficient.

If a review is to take place, that review must be conducted with the focus on protecting the interests of investors and promoting the efficiency of the marketplace as a whole – both within Canada and in global markets. International standards and best corporate governance practices demand that **all** shareholders have equal rights to receive information and participate in the shareholder democratic processes. The obligations that are imposed on issuers and intermediaries to support those rights should encourage efficiency and accuracy of the process. The 'rights' of issuers and intermediaries at best should be subordinate considerations in the process.

I hope these remarks are of assistance. If you have any questions or I can be of any further help, please feel free to contact me.

Yours truly,

(signed T.J. MacLaren)

Tanis MacLaren
Managing Director