Dean Peloso Consulting

226 Ranleigh Avenue
Toronto, Ontario
M4N 1X4

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John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, Ontario M5H 3S8
Fax: 416.593.2318
Email: jstevenson@osc.gov.on.ca

Dear Mr. Stevenson:

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

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Thank you for the opportunity to comment on the above Notice. I commend the OSC for the initiation of this review and encourage further consultation with the remaining members of the CSA as any proposals considered need to be national in scope.

By way of background, I have been around and played many roles, regulatory and otherwise in Canada's capital markets.

- As the Director of Listed Company Reporting at the TSX, I was responsible for regulating company compliance with the rules of the Exchange and oversaw listed company reporting. Part of this role included oversight of annual meetings. It's noteworthy that the largest single source of complaints received during my time in that role related to the proxy voting system. Typical complaints received included:
    - Inability to vote at a meeting
    - Failure to receive shareholder materials in advance of the meeting
    - Lack of consistency amongst companies' i.e. different rules and procedures employed resulting in significant confusion of shareholders and other stakeholders.
    - Large blocks of votes not received
    - Votes not counted
- While at the Exchange, I was a member of the team that helped launch SEDAR. I then joined CDS INC., as the executive responsible for the electronic regulatory facilitation business which subsequently went on to establish and launch the SEDI and NRD systems. During my time in that role, complaints of impaired shareholder democracy, similar to those listed above and directly attributable to the proxy system,

were quite common. Typical complainants were small disenfranchised shareholders who were completely mystified by the system and looking for somewhere - anywhere to find resolutions and answers.

- I have served on the boards of public companies and seen the tremendous cost in time and resources required to decipher and comply with rules and manage the shareholder communications process.

- I've also served on boards during times of major corporate actions (i.e. take-over bids) and times of significant turmoil (i.e. proxy contests). It's at those critical times when stakeholders most need the proxy system to fulfill its role and work well. Unfortunately it's been my experience that is exactly when it's least likely to do so … or perhaps when the significant flaws become most apparent.

Capitalism is a cornerstone of modern democracies, the source of tremendous economic growth and prosperity. Much of capitalism's benefits can be credited to public companies which limit liabilities and separate ownership from management to facilitate risk-taking and capital-raising. However this only works if owners are effectively represented by responsible boards and can maintain their say through effective proxy voting systems. That's no longer conclusively true in Canada.

In my opinion, shareholder democracy in Canada is no longer effectively served by our current proxy system and it's time for a thorough review and overhaul.

Comments on Specifically Identified OSC Issues

What follows are my comments on the specific issues raised in the Notice. The first two are specific while the third is broader and more comprehensive. It is this third issue, the "Effectiveness of the proxy voting system" that is of the greatest interest and comprises the majority of my response. Certainly all voting, whether for the election of directors, Say-on-Pay or amending a stock option plan, is reliant on an effective, consistent, auditable voting system. Anything that undermines the confidence in the system undermines the confidence in the vote.

The opinions expressed herein are formed from my own experiences to be sure; but they are also informed by the Discussion Paper – The Quality of the Shareholder Vote in Canada by Carol Hansell and her team at Davies. That paper is the most comprehensive attempt I have seen to map the history, mechanics and policies behind our current system. This was a critical level setting endeavour, an essential undertaking for understanding where we are and how we got there. It highlights the key issues and identifies areas for further research before moving onto resolutions and creating a better system. Carol and her team are to be commended for their remarkable effort in this regard.

Slate Voting and majority voting for uncontested director elections

Under the current voting system for an uncontested meeting, shareholders typically have a choice of voting for the slate or withholding their vote. A vote withheld does not count against the slate and so the slate is elected. There are two problems here:

1. The first issue is slate voting itself. Each director should be accountable to the shareholders separately and distinctly. Therefore each director should be subject to a discrete vote for or against his or her ongoing participation on the board.

2. The second issue is plurality. Under the current system, votes that are withheld do not count as votes against; so in theory all shareholders save one could withhold from voting for a particular director and yet he/she would still be elected to serve. This is clearly undemocratic and deprives shareholders of their say. The system needs to be changed such that votes for individual directors are either for or against with a criteria of a majority of the votes cast to be voted in favour in order for a director to be elected.

The introduction of individual votes for and against each director candidate with the requirement of receiving a majority of the votes cast in order to be elected will go a long way towards improving the democracy of director votes. Certainly it provides shareholders with the ability to remove underperforming or disinterested directors. Furthermore, adding this requirement doesn't add a significant burden to any of the players - issuers, directors or shareholders – and is therefore easily accommodated. It's possible that companies may be temporarily left short of directors or caught by the quorum rules in their by-laws. In this case, appropriate transitional provisions would be required to manage until the vacancy is filled.

Mandated shareholder advisory votes on executive compensation

A Say-on-Pay advisory vote can serve as an important feedback mechanism, from shareholders to directors, regarding their approach to the significant responsibility of managing executive compensation. As outlined in the Notice, securities regulators have made terrific improvements to annual compensation disclosure thereby arming shareholders with the necessary information on which to make their judgments.

However, in the vast majority of companies, and in particular smaller Canadian ones, executive compensation remains relatively stable from year to year. As a consequence, Say-on-Pay votes need only be mandated to be held at least once every three years, or in the case of a material change, at the first annual meeting following the change. With regard to "golden parachute" payments these are typically put in place well in advance of an imminent merger or acquisition. Such "golden parachute" provisions should be considered material and need to be voted on when they are established. Additional consideration should also be given as to whether there is merit in a separate Say-on-Pay vote for director compensation, which has experienced a material escalation in recent years.

It's important that directors remain fully responsible for overseeing and approving executive compensation and ensuring it remains aligned with the long term strategic goals of the company. Given that, it's also important that Say-on-Pay votes remain solely advisorial. The board should be required to take the votes into account though when considering the construct of future compensation practices. In the context of a negative vote they should be called on to disclose, as part of their future compensation disclosure, their approach to understanding the vote and their response to it.

Effectiveness of proxy voting system

As previously stated, there's a reasonable probability that the current proxy voting system lacks the required integrity for all stakeholders to have full confidence the system works as needed to support of shareholder democracy. Given the importance to capital markets, my recommendation is the initiation of a comprehensive CSA-sponsored review of the system, by a task force of un-conflicted stakeholders and interested parties, as soon as is practicable.

There are a number of specific areas that need to be considered as part of that review. In working through these I'll use the framework from the Discussion Paper – The Quality of the Shareholder Vote in Canada by Carol Hansell to present my thoughts.

First regarding the **Elements of an Effective System**, the Discussion Paper outlines the following five criteria:

1. investors must be in a position to make an informed decision about how to vote or how to direct that their votes be exercised and must therefore have adequate time to review the proxy materials;

2. investors must be able to cast their votes or provide voting instructions in accordance with rules that are clearly explained, impartially applied and practical for investors to follow;

3. if an investor casts a vote or provides voting instructions in accordance with the established rules, that vote must be given its full weight at the shareholder meeting in question;

4. votes attached to the securities of an issuer should be cast by those investors who hold the economic interest associated with those securities; and

5. there must be sufficient transparency in the voting system so that both issuers and investors are confident that the system works.

I endorse these elements or principles as the criteria by which the current system should be measured and by which the new system should be designed. With regard to Element # 2, I would further emphasize that voting instructions and rules must be simple and consistently applied across companies. As a practical consideration, the current voting instructions and rules offer too much flexibility in terms of cutoff dates, wording on proxies, colour of paper used, delivery approaches, etc. This only serves to confuse investors and impair the quality of the vote.

The Discussion Paper goes on to outline **Key Issues That Need to be Addressed** prior to solutions being developed. These were:

1. **Access to Information** - There is not enough information available about the proxy voting system to allow an independent party to either prove that systemic problems exist or provide the confidence that they do not. Most of the information about the operation and effectiveness of the system resides with third-party service providers (transfer agents, proxy agents, proxy advisors and proxy solicitors) who have a great deal invested in the system and whose business interests would be affected by any change in the system. We hope this paper will contribute to a better understanding of the issues among issuers and investors. However, a more comprehensive audit of the system must be conducted by a task force of subject matter experts appointed by the government or by securities regulators.

2. **Movement Away from Paper-Based System** - Some of the problems in the proxy voting system will be eliminated when issuers are no longer obligated to provide hard copies of their proxy materials to their investors. There will always be some investors who prefer paper versions of the materials, but there is a point at which the cost to the issuer and the mechanical complications outweigh the importance of providing the

materials in the medium of choice to the investor. Canadian regulations need to do to more to encourage the transition away from paper-based materials. Notice-and-access is a step in this direction, but the recent proposals by the CSA are only a first – and quite tentative – step towards a true paperless system.

3. **Revisiting the Commitment to the OBO Concept** - One of the hallmarks of the Canadian (and US) proxy voting system is that investors may elect to conceal their identity from the issuer (the OBO/NOBO system). The fact that issuers cannot communicate directly with many (today almost half) of their investors makes the communication process much more complicated.

4. **Problems Created by Intermediary Files That Are Not Reconciled for the Purpose of Proxy Voting** – Intermediaries (brokers, banks, custodians) are required to create a list of their clients who are entitled to vote at a shareholder meeting, together with the number of shares held by those clients. However, those lists are often "unreconciled". They have not been adjusted to eliminate, for example, shares that have been loaned. The loaned shares will therefore still appear on the list prepared by the lender's intermediary for voting purposes, and will appear on the list prepared by the borrower's intermediary for voting purposes. As a result, the vote attaching to a single share may be voted more than once.

5. **Issues Related to Broadridge's Place in the Market** – Almost all of the intermediaries in Canada have outsourced their responsibilities in connection with communications between issuers and investors to Broadridge. Broadridge has played a leading role in improving and streamlining the proxy voting system in Canada. However, Broadridge is not subject to regulation in Canada and neither issuers nor investors have a line of sight into how Broadridge has handled the voting instructions from investors in connection with any particular meeting.

6. **Deciding Whether Empty Voting Matters and How to Deal With It** – There is no question that empty voting occurs. The problem is that there is no way to determine how extensive it is. If it has no real impact on the outcome of a shareholder vote, perhaps there is no reason to focus on it. If, however, it were shown that it happens more than rarely and could have a material impact on the results of a shareholder vote, then the basis of shareholder decision making may come into question.

7. **Power of the Proxy Advisory Firms** – Many institutional investors rely heavily on the recommendations of proxy advisory firms in deciding how to vote their proxies. Some issuers feel that the degree of de facto reliance gives proxy advisory firms the power essentially to dictate governance practices. Others are concerned that the proxy advisors do not understand issues specific to that issuer or even that they get some things wrong in their analysis. Finally, some are concerned with conflicts of interest where a proxy advisor both sells governance consulting services to issuers and provides voting recommendations to investors. A better understanding of the role and methods of proxy advisory firms is needed. In addition, issuers need a forum in which to articulate their concerns - a forum that would be capable of providing responses and solutions that alleviate the current concerns.

8. **Responsibilities of Investors** – Do investors have any responsibilities to the issuers in which they invest or to the capital markets generally? Should they be expected to vote? If so, how do they reconcile securities lending with their proxy voting policies? These issues are receiving increased focus and in some cases affect other issues

addressed in the paper. Institutional investors should engage actively in the issues facing the proxy voting system and the role that they play.

9. **Engagement of Securities Regulators** - Securities regulators must acknowledge the importance of an effective and reliable proxy voting system. They should be championing a comprehensive review of the system and be prepared to regulate aspects of the system in which they have not been involved.

Once again I'm in general agreement with the issues identified and make the following additional comments.

With regard to Issue # 2, **Movement Away from Paper-Based Systems**, I would go further to say that the new system **must** be electronic. The application of computerized technology in the design of a new system has the potential to deal with vast majority of the identified problems. The system must be electronic and the delivery of paper materials should be relied upon only under exceptional circumstances. Regardless, when paper delivery does occur under exceptional circumstances, the voting must still be electronic. Full consideration should also be given to the development of a national shareholder registry.

In general, I'm in favour of **Revisiting the Commitment to the OBO Concept.** In an ideal world, all beneficial holders would be treated, to the greatest extent possible, like registered holders. This is more easily done for NOBO's than OBO's and one response, as proposed in the recent amendments to National Instrument 54-101, is to limit the way the voting instructions are provided to all beneficial holders. That's not a good response. NOBO's should not be disadvantaged by virtue of issues not pertaining to them. Another response would be to discriminate solely against OBO's since in essence that's what they've agreed to in exchange for maintaining their privacy. Unfortunately that doesn't lead to improved shareholder democracy. The better response would be to stick to the original objective of treating beneficial holders as much as possible like registered ones. If the application of technology in a well-designed electronic system allows OBO's and NOBO's to co-exist such that they're both treated essentially similar to registered holders, then that is what should be done. If it is not possible, through the application of technology, then consideration should be given to removing the right of investors to adopt or maintain OBO status.

One of our principles is that it's fundamental to an effective system that votes attached to the securities of an issuer be cast by the investor who holds the economic interest associated in those securities. Issue # 4, **Problems Created by Intermediary Files That Are Not Reconciled for the Purpose of Proxy Voting** provides an example where this principle would be violated. That's unacceptable. A shareholder registry would go at least part of the way to resolving this issue. It might also be that additional electronic filing requirements are required for intermediaries who engage in share lending activities.

Regarding **Issues Related to Broadridge's Place in the Market,** it's clear that given the importance of proxy system to Canadian capital markets that all significant intermediaries be subject to at least some minimal regulation, audit and/or oversight as required to ensure the efficacy of the system.

The **Power of the Proxy Advisory Firms** presents an interesting challenge in that they are heavily relied on by institutional investors. However the full relationship between the parties is unclear and frankly appears to be woefully conflicted. I've experienced all of the following in my past dealings with Proxy Advisors:

- A Proxy Advisor soliciting an institutional investor's preferred voting recommendations
- Selective sharing of a vote recommendation in advance of publication
- Request to issuers for private information when it was thought that it would support institutional shareholder preferences …and subsequently ignoring that information when it did not support the proxy advisors current recommendation
- Material misunderstanding the issues at hand
- Obvious mistakes in analysis

A thorough review of the role, methods, disclosure practices and relationships relating to Proxy Advisors is an absolute necessity. Additional consideration should also be given to the responsibilities of institutional investors in the use of proxy advisors vis-à-vis their responsibilities to their clients.

Additional Considerations

As part of a comprehensive review, the following two additional Issues should be considered for the task force mandate:

1. **Establishment of a Share Capital Reporting System** – Current systems for recording share capital suffer from a multitude of problems (i.e. not timely, frequently out of date, multiple conflicting sources, poor and uneven disclosure, hidden dilution, etc.). They are simply not reliable. It's fundamental to capital markets that a shareholder knows his relative ownership of a company. Without comprehensive reporting this is not possible. In conjunction with a shareholder registry, share capital reporting would provide the essential clarity and create a zero-sum process where empty voting or over voting becomes more apparent and traceable. Consideration of this requirement should be part of the task force mandate.

2. **Economic Model** – Clearly a new proxy voting system will not be free. In all likelihood it will also impact the economic interests of some or all of the current players. The task force looking at the system should as part of its mandate make recommendations on the proposed economic model for supporting the system along with an assessment of the disintermediation and economic impacts.

Please do not hesitate to contact me directly (deanpeloso@rogers.com; 647.298.0842) if you would like to discuss any of these comments in more detail.

Sincerely,

Dean Peloso
President –
Dean Peloso Consulting