



**CENTER FOR CAPITAL MARKETS**  
**COMPETITIVENESS**

**TOM QUAADMAN**  
VICE PRESIDENT

1615 H STREET, NW  
WASHINGTON, DC 20062-2000  
(202) 463-5540  
tquaadman@uschamber.com

August 14, 2012

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
The Manitoba Securities Commission  
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Nova Scotia Securities Commission  
Registrar of Securities, Northwest Territories  
Superintendent of Securities, Yukon  
Registrar of Securities, Nunavut

Me Anne-Marie Beaudoin  
Corporate Secretary  
Autorité des marchés financiers  
800, square Victoria, 22e étage  
C.P. 246, tour de la Bourse  
Montréal (Québec) H4Z 1G3

Mr. John Stephenson  
Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1900, Box 55  
Toronto, Ontario  
M5H 3S8

RE: CSA Consultation Paper 25-401 "Potential Regulation of Proxy Advisory Firms"

Dear Sirs or Madams:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation representing the interests of more than three million businesses of every size, sector, and region. The Chamber created the Center for Capital Markets

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Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. To that end, it is an important goal of the CCMC to insure the integrity of the corporate governance system, and particularly of the proxy advisory firms that have such a tremendous influence over it, both in the United States and Canada.

The CCMC appreciates the opportunity to submit comments in connection with the Canadian Securities Administrators Consultation Paper 25-401, *Potential Regulation of Proxy Advisory Firms* (“Consultation Paper”). It is important to recognize that proxy advisors can serve an important role in the corporate governance process. Proxy advisors are in a position to serve their institutional shareholding clients by synthesizing corporate governance information from regulatory filings and other sources to aid in proxy voting. This specialization has the potential to improve institutional investors’ decision making processes by providing an efficient mechanism to evaluate proxy proposals over a wide number of public companies in an institutional shareholder’s portfolio.

However, the CCMC is concerned about the lack of transparency and potential conflicts of interest in the operation of proxy advisory firms that advise institutional shareholders on matters of corporate governance, and have tremendous influence over public companies’ corporate governance practices. We are also concerned that voting recommendations may not actually reflect the economic interest of the individual beneficiaries and other participants in pension plans and other institutional funds that outsource their proxy voting to proxy advisors. Indeed, given their lack of written standards and transparency, we are concerned that proxy advisors to some degree serve instead the narrow interests of a small group of vocal shareholder activists that may have an agenda unrelated to the best interests of the vast majority of shareholders. A systematic failure to make the right voting recommendations, for the right reasons, can adversely impact the companies involved, and in the long run cause negative economic consequences for both the companies and their investors.<sup>1</sup>

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<sup>1</sup> These issues are raised in the context of the two largest proxy advisors, Institutional Shareholder Services (“ISS”) and Glass, Lewis & Co., LLC (“Glass Lewis”). For illustrative purposes, we note that in the U.S., these advisors collectively influence more than 30% of votes cast in U.S. corporate elections and wield even greater influence outside of the formal voting process, as public companies frequently cite the voting policies of these advisors as high among the driving factors of boards’ decision making processes. *See e.g.*, “Say-on-Pay Votes Change, Enhance Role of Proxy Advisory

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Our comments are discussed in more detail below.

### Discussion

#### **1. Processes for policy formulation and application of proxy voting policies lack transparency, and appear to lack objectivity and balance, undermining the credibility of the proxy voting system.**

Proxy voting policy is formulated and applied differently by each proxy advisor. Each, however, falls woefully short in terms of following standards and practices that are necessary to provide the marketplace with assurances that proxy voting recommendations are transparent, objective, and balanced.

Neither proxy advisor appears to have formal standards and procedures upon which substantive policy decisions are made, or have requirements to take into account public input or to identify and develop statistical and other relevant evidence related to shareholder returns. ISS, for instance, frequently cites its annual policy survey and open comment period as examples of the transparency and responsiveness of its policy formulation process. However, even a cursory review of the 16 U.S. voting policies updated by ISS in 2011 reveals that ISS personnel responsible for writing ISS's policies are not required address survey results or written comments submitted to ISS that contradict ISS's chosen policy position or would support an alternative policy.<sup>2</sup> Glass Lewis' policy making process is generally considered to be even less transparent and responsive.

Internal deliberations and meetings regarding policy matters are also not transparent.<sup>3</sup> This lack of transparency and accountability has raised questions regarding voting recommendations while fostering a lack of confidence in the overall

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Firms, Many Agree". Bloomberg BNA (June 22, 2012). *See also* Larcker, McCall and Tayan "The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions". Available at <https://www.conference-board.org/retrievefile.cfm?filename=TCB-DN-V4N5-12.pdf&type=subsite>.

<sup>2</sup> *See generally* U.S. Corporate Governance Policy 2012 Updates (November 17, 2011). Available at [http://www.issgovernance.com/files/ISS\\_2012US\\_Updates20111117.pdf](http://www.issgovernance.com/files/ISS_2012US_Updates20111117.pdf).

<sup>3</sup> By contrast, U.S. regulators post a memo on their websites regarding meetings on policy issues and rule makings, citing the people and organizations that have held meetings with the regulators and the subject matter of the meetings.

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policy development and implementation. Consequently, this leaves the proxy advisors open to charges that their policy development lacks objectivity and balance, leading to decisions that may be arbitrary, capricious or show favoritism. This lack of openness to scrutiny has led to a lack of confidence, by some, in the existing systems.

Therefore, we recommend that policy options that are adopted out of the policy process that includes the Consultation Paper should ensure that proxy advisory firms' policy making process comply with the following procedures, which will greatly enhance proxy advisory firms' reputation in the marketplace and significantly improve public confidence in proxy advisory firms' ability to operate in a balanced and reasonable manner, and in the interests of the ultimate owners and beneficiaries of the public equity held by their institutional clients:

- Publish written standards for policy development and implementation, which require that policies be based in an objective and balanced manner on statistical and other evidence that is available or reasonably attainable, and input from interested parties.
- Require advance notice of any proposed changes to voting policies and an adequate opportunity for public input on any proposed changes before implementation. Specified proposed changes should be published for public comment for a minimum specified period, allowing for a uniform system of written input from companies, investors, and other interested parties.
- Require that all other contacts with interested parties on specific proposed changes be documented and included in the public file, along with any other submitted evidence, including completed questionnaires and other surveys that have been submitted by interested parties. All other evidence relevant to the policies in question should also be placed in a public file.
- Conform to other basic requirements for transparency and due process, including providing for transparency of any deliberations about new or

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amended policies and instituting an open process to allow companies to appeal decisions made in policy development and recommendations.<sup>4</sup>

- Provide for an annual review of existing policies to determine whether change is needed and to solicit input on any identified current developments. For example, hold an annual discussion forum with industry constituencies, academics, and other interested parties to address specific or localized topics.
- Provide for an annual industry-wide review of impact on policies on proxy voting in order to identify potential issues in the voting recommendation process. Review identified industry-wide impediments to the efficient and accurate use of these voting recommendations.

Additionally, each proxy advisor should develop a formal appeal process for issuers to formally raise points of contention with factual claims or recommendations contained in a proxy advisory report. At a minimum, a formal appeals process should provide issuers with a consistent point of contact for raising such issues, a balanced decision making process, and written standards against which decisions will be evaluated. Procedures should require a written response to appeals within a reasonable amount of time. While both proxy advisors noted above claim to have voluntarily adopted appeals processes,<sup>5</sup> both are devoid of the detail, written standards, and transparency that would lend some amount of credibility to these measures.

## **2. The proxy advisory industry is fraught with potential conflicts of interest that undermine the credibility of proxy advisors' voting advice and raise questions about the legitimacy of the proxy advisory industry.**

Public confidence in both advisors' ability to approach their corporate governance policies and voting recommendations in a balanced and fair manner is

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<sup>4</sup> These are among the central policymaking safeguards provided for in the United States by the Administrative Procedures Act.

<sup>5</sup> In the case of ISS, *see* <http://www.issgovernance.com/press/frb>. In the case of Glass Lewis, *see* <http://www.glasslewis.com/for-issuers/glass-lewis-corporate-engagement-policy/>.

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severely undermined by actual or apparent conflicts of interest. Both advisors count among their advisory clients both public companies, upon which they also provide vote recommendations, and public or non-public shareholders that sponsor shareholder resolutions to be voted on at their portfolio companies. It is difficult, in the absence of a public record of meetings held between proxy advisory personnel and outside interested parties, to say with certainty to what extent these potential conflicts of interest influence the advisors' vote recommendations. Nevertheless, neither advisor appears to have policies in place that are sufficient to address these apparent conflicts.

In addition, both ISS and Glass Lewis each appear to have other sources of conflicts that may impair their impartiality:

a. Institutional Shareholder Services

ISS, in addition to advising shareholders on how to vote their shares, also provides fee-based consulting services to covered companies that are willing to pay to have ISS advise them for the purpose of improving their corporate governance ratings and increasing the likelihood of receiving favorable vote recommendations from ISS' proxy advisory service. According to the annual report of ISS' publicly-traded parent company, revenues related to ISS Corporate Services products and services represented 21.2% of Governance business total revenues during each of the last two years.<sup>6</sup> ISS defends this practice by claiming that its proxy advising and consulting personnel are separated by a firewall that prevents them from coordinating. ISS also provides vague and generalized disclaimers in its proxy advisory reports notifying its clients on its institutional side of the fact that ISS provides consulting services to issuers.<sup>7</sup> In short, it appears that ISS gives the *appearance of transparency* in its provision

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<sup>6</sup> MSCI Inc., Annual Report on Form 10-K, at 9 (Feb. 29, 2012).

<sup>7</sup> While ISS's generic disclosure does also notify its institutional clients that they may request additional information about an issuer's use of ISS consulting products and services, it would be impractical for an institutional client with many and diverse holdings to inquire separately about ISS consulting relationships with each company in the client's portfolio. The following non-specific disclosure appears on the last page of ISS reports: "This issuer may have purchased self-assessment tools and publications from ISS Corporate Services, Inc. ("ICS"), a wholly-owned subsidiary of Institutional Shareholder Services Inc. ("ISS"), or ICS may have provided advisory or analytical services to the issuer in connection with the proxies described in this report. No employee of ICS played a role in the preparation of this report. If you are

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of consulting services without providing detailed factual disclosure and transparency around its processes that would enable any real evaluation of the potential conflicts of interest.

Because more than one out of every five dollars of ISS' revenue is generated from issuer consultants whose purpose is to advise issuers on how to meet governance standards, and presumably achieve compliance with the proxy voting policies of the institutional advisory side of the business, the potential for conflicts of interest is tangible. The less transparent and more opaque ISS' voting policies and recommendations, the more issuers will feel compelled to hire ISS's consulting services. Thus, the institutional advisory side of the business could have a very powerful incentive to promulgate policies without providing public stakeholders with enough specific information about those policies. In the absence of transparency and detailed disclosure relating to the potential conflicts, it is impossible to evaluate their actual impact, but at a minimum the apparent conflict of interest in our view continues to erode public confidence in the proxy voting system in the United States.

b. Glass Lewis

Glass Lewis is owned by the Ontario Teachers' Pension Plan ("Ontario"), an activist pension fund with more than \$117 billion in assets under management, including \$10.6 billion invested in Canadian equity securities and \$41.1 billion invested in non-Canadian equities.<sup>8</sup> As an activist pension fund, Ontario frequently takes ownership positions in companies with a view toward encouraging or forcing changes on the company's management, often through the use of the proxy voting process.<sup>9</sup> This practice at a minimum creates the appearance of a conflict of interest for Glass Lewis, as the unique interests of Ontario may be reflected formally or informally in the proxy voting recommendations that Glass Lewis provides to guide its clients'

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an ISS institutional client, you may inquire about any issuer's use of products and services from ICS by emailing [disclosure@msci.com](mailto:disclosure@msci.com)."

<sup>8</sup> See [http://www.otpp.com/wps/wcm/connect/otpp\\_en/Home/Investments/Fast+Facts/](http://www.otpp.com/wps/wcm/connect/otpp_en/Home/Investments/Fast+Facts/)

<sup>9</sup> See [http://www.otpp.com/wps/wcm/connect/otpp\\_en/Home/Investments/Public+Equities/Relationship+Investing/how+we+invest/](http://www.otpp.com/wps/wcm/connect/otpp_en/Home/Investments/Public+Equities/Relationship+Investing/how+we+invest/)

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proxy voting. For instance, Ontario recently publicly announced its support of a dissident slate in a proxy contest for control of Canadian Pacific Railway Ltd. (“CP”), and Glass Lewis’ vote recommendation, which was also in support of the dissident slate, came out the very next day.<sup>10</sup> Similar situations in which the publicly stated stances of Ontario could have influenced the voting advice of Glass Lewis have also been observed.<sup>11</sup>

While the sources of potential conflicts of interest are different, each threatens to undermine public confidence in the proxy voting process. While providing minimal and usually very generalized disclosure about the potential for conflicts, ISS and Glass Lewis fail to provide specific disclosures that would permit all stakeholders to evaluate for themselves whether the proxy voting advice upon which important corporate decisions are made is tainted by interests other than the best interests of the companies and their shareholders. Further, in some cases such as the CP proxy contest noted above, disclosure alone may not be sufficient to cure these actual or apparent conflicts of interest.<sup>12</sup>

Therefore, any policy response of the CSA should take into account the ownership structure and operations of the proxy advisory firms and the extent of their influence on voting recommendations. It is important to consider, among other things, whether proxy advisors must be required to recuse themselves from providing recommendations under certain circumstances, including when a company that is the subject of the recommendations is also an advisory or consulting client of the proxy advisor, or when the proxy advisor’s owner has a material interest in the outcome of the vote. Both situations bring into question whether institutions fulfill their fiduciary

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<sup>10</sup> See “UPDATE: Glass Lewis Supports Ackman’s Canadian Pacific Board Slate” Wall Street Journal online (May 9, 2012). Available at: <http://online.wsj.com/article/BT-CO-20120509-712663.html>. See also CCMC letter to SEC Chairman Schapiro Asking for the SEC to Monitor Glass-Lewis & Co. (May 30, 2012). Available at: <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-5.30-Glass-Lewis-letter-release.pdf>

<sup>11</sup> See CCMC letter to SEC Chairman Schapiro re: McGraw-Hill (September 12, 2011). Available at: <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/McGraw-Hill-Letter-9.12.2011.pdf>.

<sup>12</sup> See CCMC letter to DOL Regarding Glass, Lewis & Co., LLC (June 25, 2012). Available at: <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-6.25-DOL-Letter-re-Glss-Lewis-Canadian-Pacific.pdf>



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duty to their individual beneficiaries and plan participants when they rely on the potentially conflicted advice of proxy advisors.

### **Conclusion**

The CCMC would once again like to thank the CSA for the opportunity to provide comments on its Consultation Paper. Given the tremendous influence of the proxy advisory industry over corporate governance in both the U.S. and Canada, we believe it is imperative that steps be taken to resolve the proxy advisors' lack of transparency in formulating and applying proxy voting policies and to prevent proxy advisors' conflicts of interest, which may harm clients, issuers the marketplace as a whole.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' with a long horizontal flourish extending to the right.

Tom Quaadman