



August 15, 2012

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Office of the Attorney General, Prince Edward Island
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

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Re: Request for Comments – Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms

We are writing in response to the Canadian Securities Administrators' (CSA) request for comments on *Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms*. NEI Investments commends the CSA for seeking input in this process.

NEI INVESTMENTS

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With approximately C\$5 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 build long-term sustainable value for all stakeholders and provide higher risk-adjusted returns to shareholders. As an investment institution, we have experience as a client of several of the major proxy voting advisory firms.

Main observations

Although we have some concerns about proxy voting advisory services, we would question whether this is the biggest priority for regulatory reform within the proxy voting system. We are more concerned about other issues: being able to vote at all in the international context; enhancing the assignment of voting rights so that it is not only more accurate, but also supports and rewards a long-term sustainable value perspective among investors; and creating a system that provides assurance that our shares are being voted in accordance with our instructions. We have no control over these challenges at present, while the extent to which we rely on proxy advisors does lie within our own control. The CSA paper does not discuss these more pressing concerns. In contrast, the 2010 Securities and Exchange Commission (SEC) *Concept Release on the U.S. Proxy System* presented a wide-ranging overview of proxy voting challenges. We recognize that efforts are underway to explore “proxy plumbing” issues under the auspices of the Canadian Society of Corporate Secretaries and the Canadian Coalition for Good Governance (CCGG), but this larger context is not mentioned. We believe the issues covered in this paper are of more concern to issuers than to institutional investors.

Proxy voting advisors provide important services for investment institutions. Proxy voting platform and vote disclosure services are essential to us, and proxy research is extremely useful, especially for international holdings. However, we do not follow the recommendations of our proxy voting advisors blindly. We have our own detailed proxy voting guidelines¹ and we check each vote for compliance with those guidelines.

We have had experience as a client of several of the leading providers of proxy voting services. Over the years we have seen instances of poor-quality research, and have been obliged to over-ride vote recommendations because we disagreed with the research conclusions or because our custom guidelines had not been followed accurately. However, we see these occurrences as a client-advisor problem that in the first instance should be dealt with by the market, or by the development of voluntary industry standards among advisors. We would not wish to see a situation in which unnecessary or premature regulation reduced competition between service providers. We already consider the number of players in the market to be rather limited, and would prefer to see more choice. There are real issues with research quality, but interventions that forced providers to make important intellectual property public, or rendered their business models less economically viable, would likely reduce the quality of research rather than enhancing it.

Overall, we are not convinced that this is a regulatory priority. However there are some areas in which advisors could enhance performance, and which could be taken up either in the policies and practices of individual advisors or within voluntary industry standards:

- We would see value in enhanced disclosure on conflict of interest policies, specific conflict of interest situations and what has been done to manage the situation (beyond the current boilerplate disclosure). Details of relationships and communications between advisors and other stakeholders with an interest in a specific research report should be included in the report in question. For example, we regularly file shareholder proposals, and advisors sometimes

¹ For more information see NEI Investments' proxy voting guidelines available at: <https://www.neiinvestments.com/Pages/ESGServices/EngagingCompanies/ProxyVoting.aspx>

Speak with us about those proposals in the course of preparing their research. It would be appropriate for these contacts to be disclosed in the research report.

- To enhance research quality, there is value in letting issuers and proposal proponents see draft research, so they can comment on the accuracy of research and analysis. However, this communication should not be allowed to influence the recommendation.
- We are sometimes puzzled at how the advisor has arrived at the final vote recommendation based on the research provided in the report. Enhanced disclosure to clients and issuers/proponents on analytical methods and the rationale for the vote recommendation would therefore be desirable in reports. However, this information does not need to be placed in the public domain.

Finally, to enhance client choice, we would encourage providers to “unbundle” proxy voting platform, disclosure and research services, so that clients can more easily purchase services relating to different aspects of the proxy voting process from different providers, and assemble the package of services that best meets their needs.

Specific comments in response to questions posed by CSA

General

1. Do you agree, or disagree, with each of the concerns identified in the Consultation Paper, namely: (i) potential conflicts of interest, (ii) perceived lack of transparency, (iii) potential inaccuracies and limited engagement with issuers, (iv) potentially inappropriate influence on corporate governance practices, and (v) the extent of reliance by institutional investors on the advice of such firms? Please explain and, if you disagree, please provide specific reasons for your position.

We agree that there are some concerns relating to potential conflicts of interest, perceived lack of transparency, and potential inaccuracies in research.

We are less convinced that serious concerns exist in the other areas highlighted in the paper:

- *Engagement with issuers (iii):* We are not convinced that proxy voting advisors need to enhance engagement with issuers, according to our understanding of the term. The primary responsibility for engaging issuers to upgrade their corporate governance practices lies with direct stakeholders such as regulators and investors. We do see value in proxy voting advisors communicating with issuers on research findings, to ensure that research is as accurate as possible.
- *Potentially inappropriate influence on corporate governance practices (iv):* We view the emergence of de facto corporate governance standards setters, including proxy voting advisors and institutional investor organisations such as CCGG, as more positive than negative. We have not seen strong evidence that this is harming companies’ ability to build long-term sustainable value. Where issuers believe that alternate corporate governance models will serve company stakeholders better, they are free to explain this in their disclosure.
- *Extent of reliance by institutional investors on the advice of such firms (v):* Proxy voting advisors are providing important services. Voting platform and vote disclosure services are essential for us, and proxy research is extremely useful, especially for international holdings. However, we do not follow our advisors’ recommendations blindly. We have our own detailed proxy voting guidelines, and we check each vote for compliance with those guidelines.

4. Do you believe that the activities of proxy advisory firms should be regulated in some respects and, if so, why and how?

We do not think that a regulatory response is warranted at the present time. Indeed, we are concerned that premature or unnecessary regulation might create barriers to entry to the industry that could reduce competition between service providers. We already consider the number of service providers in the market to be rather limited, and would prefer to see more choice, not less. We would, however, encourage proxy voting advisory firms to enhance their policies and practices, and consider developing industry standards, to address some of the issues raised in this consultation and highlighted in this submission.

Potential conflicts of interest

5. To what extent do you consider proxy advisory firms to: (i) be subject to conflicts of interest in practice, (ii) already have in place appropriate conflict mitigation measures, and (iii) be sufficiently transparent regarding the potential conflicts of interests they may face? If you are of the view that current disclosure by proxy advisory firms regarding potential conflicts of interest is not sufficient, please provide specific examples of such insufficient conflicts of interest disclosure and suggestions as to how such disclosure could be improved.

We would see value in enhanced disclosure on conflict of interest policies, specific conflict of interest situations and what has been done to manage the situation (beyond the current boilerplate disclosure). Details of relationships and communications between advisors and other stakeholders with an interest in a specific research report should be included in the report in question. For example, we regularly file shareholder proposals, and advisors sometimes speak with us about those proposals in the course of preparing their research. In some cases, we also have a client relationship with the advisor. It would be appropriate for these contacts to be disclosed in the research report.

Perceived lack of transparency

8. Could disclosure of underlying methodologies and analysis provide beneficial information to the market or would the commercial costs of doing so be too significant?

On occasion, we have been puzzled as to how an advisor has arrived at the final vote recommendation on the basis of the research findings in a report. Including more detail on analytical methods and vote rationales in reports for the benefit of clients, issuers and proposal proponents may therefore be desirable. However, as methodological information may constitute important proxy voting advisor intellectual property, we see no pressing reason why this information should be disclosed in the public domain.

Issuer engagement

9. To what extent could there be an improvement in the dialogue with issuers during the vote recommendation process?

To enhance research quality, we believe there is value in letting issuers or proposal proponents see research in draft, so they can comment on the accuracy of content and analysis. However, it would not be appropriate to increase the potential for issuers or proposal proponents to influence the vote recommendation. When we have filed proposals ourselves, we have sometimes challenged the quality and accuracy of a proxy research report, for example because it has misrepresented our position as set out in the proposal, or because of mistakes in the background research. However, we make it clear in these discussions that we only seek to discuss quality and accuracy questions, and we accept that the decision on the recommendation should be taken independently by the advisor.

Additional questions for institutional investors:



18. To what extent and in what ways do you rely on the services provided by proxy advisory firms? Please be as specific as possible.

We purchase a variety of proxy voting advisory services.

- Proxy voting platform allowing us to manage and execute our voting more easily: We are highly reliant not only on the advisor we have contracted, but also on a number of other entities in the “proxy plumbing” system, and lack concrete assurance at present that votes have actually been executed according to our instructions.
- Custom implementation of our own detailed proxy voting guidelines: The provider suggests how we should vote, based on our guidelines, or indicates that a manual vote is needed because our guidelines do not cover the situation in question. Our in-house analysts verify each vote, and over-ride the advisor’s recommendation if necessary.
- Proxy research to support our vote decision-making: This is a useful service, especially for international holdings and for rapid assessment of routine voting matters. However, we know from experience that research reports may contain errors and we limit our reliance on them accordingly. Key votes are referred to regularly-scheduled proxy voting team meetings for discussion and a group decision.
- Web solutions for vote disclosure, allowing rapid publication of our voting decisions and rationale in a searchable database: We rely on this service so that we can offer our unit holders disclosure that goes beyond compliance with National Instrument 81-106.
- Voting analysis functions: We make some use of services that allow for analysis of our own voting record, for reporting purposes.

19. How do you view your duty to vote and how do the vote recommendations of proxy advisory firms play a part in your decision-making process?

We have a strong commitment to engagement with the companies in our holdings. We take our duty to vote extremely seriously and regard the voting rights associated with our holdings as important assets. 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. 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. As part of our wide-ranging corporate engagement program, we also make efforts to provide feedback to issuers on the rationale for our decision on key votes, such as advisory votes on executive compensation.

While we use proxy advisory services, in-house staff members analyze and execute every vote. We review the vote recommendations of proxy advisors, but the final vote decision is our own.

21. Assuming you share the concerns identified above, do lack of choice/competition or other market factors in the proxy advisory industry limit your ability to address these concerns directly such that regulatory intervention is warranted? Please explain.

Lack of choice is a concern, but we are more concerned that premature regulatory intervention could further reduce choice and competition by creating barriers to entry or encouraging further consolidation. Choice would be improved by making it easier for investors to buy “unbundled” services from different providers.



22. *Given the above-noted concerns regarding the overall quality and lack of transparency underlying the vote recommendations of proxy advisory firms, what measures do you take and, overall, how do you gain assurance that such recommendations are reliable for your voting purposes?*

As noted above, we use the recommendations of the proxy voting advisors as an aid to our work, but we do not rely on the recommendations. We consider proxy advisor reports and recommendations alongside the proxy circular and our analysts' own research, and take our own decision.

23. *Do you view the policy development process and resulting proxy voting guidelines of proxy advisory firms as appropriate and reflective of your governance preferences and views? Would input from issuers further benefit or potentially hinder such process?*

Because of a strong commitment to responsible investment, our own proxy voting guidelines incorporate preferences on environmental, social and governance issues that are more exacting than the standard guidelines of the proxy advisory firms, which tend to reflect the middle ground of opinion. We disclose our own proxy voting guidelines, so it is not unreasonable for proxy voting advisors to disclose their core guidelines, allowing all market participants to offer critique. However, the decision on the final content of those guidelines should lie with the proxy voting advisors.

Conclusion and main recommendations

We commend the CSA's continuing commitment to seeking public input, but do not feel that regulatory intervention on this issue is warranted at present. Actions that could reduce choice and competition in the provision of proxy voting services should be avoided. In the first instance, we would prefer to see the proxy advisory industry improve standards to address concerns outlined in this submission.

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

Sincerely,

NEI Investments

A handwritten signature in black ink, appearing to read "John Kearns".

John Kearns
Chief Executive Officer

A handwritten signature in black ink, appearing to read "Robert Walker".

Robert Walker
Vice President, ESG Services

CC: Board of Directors, NEI Investments