

Hay Group Limited  
121 King Street West  
Suite 700  
Toronto, ON M5H 3X7  
Canada

tel +1.416.868.1371  
fax +1.416.868.6871

[www.haygroup.com/ca](http://www.haygroup.com/ca)

August 20, 2012

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

Re: CSA Consultation Paper 25-401 – Section 5.3. Specific Request for Comments

This letter outlines Hay Group's comments on some of the questions addressed to all market participants in the CSA Consultation Paper 25-401: Potential Regulation of Proxy Advisory Firms;

Sincerely,

Hay Group Limited



Christopher A. Chen, LLB  
National Director  
Executive Compensation  
T: 416.815.6385  
[christopher.chen@haygroup.com](mailto:christopher.chen@haygroup.com)

## 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, the Hay Group, generally agree with each of the five concerns identified in the Consultation Paper. Our perspectives on each of the concerns are further discussed in the rest of this letter.

**2. Are there other material concerns with proxy advisory firms that have not been identified? Please explain.**

No.

**3. Are there specific gaps in the current practices of proxy advisory firms which justify regulatory intervention? Is there a concern that future gaps could be created as a result of new entrants or changes in business or other practices?**

From our perspective the issue is about creating an environment where these useful advisory services can be offered in a responsible and transparent way. By removing any “black box” approaches to decision making this could theoretically create more competition in the field and remove barriers to entry.

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

We believe certain proxy advisory services should be regulated to address the issue of transparency in decision making, open dialogue and expert understanding of the business about whom the advice is being given and engagement with shareholders to ensure that the true owner’s interests are being properly represented. According to the findings from our Corporate Governance survey, proxy advisors are seen to wield significant influence over investors however their assessments often lack objectivity and depth. There is little transparency as to how decisions are reached and how their recommendations are supported. This generic approach is perceived to be limited in its applicability. Some also expressed that proxy advisors are not perceived to be fully independent because they simultaneously represent the interests of organizations and investors through their multiple service lines. They are seen to have potential conflicts of interest that diminish the credibility of their recommendations. For these reasons certain activities of proxy advisory firms should be regulated in some respects.

## 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.**

**(i) To what extent do you consider proxy advisory firms to be subject to conflicts of interest in practice.**

Most of the conflict of interest arises from a situation where the proxy advisor is advising a company on their vote as well as the investors on the same vote. If handled responsibly the proxy advisory industry doesn't need to be subject to conflicts of interest. If proxy advisors had more transparency and engaged in more robust dialogue in the advice that they provide a dual relationship of this nature could, in fact, be a very powerful and useful tool not only for helping a company guide its actions in favour of the best outcome for it and the market but then also for communicating those actions to the investor community at large.

We would suggest that as they currently operate, with a formulaic and non transparent approach, proxy advisors are indeed subject to conflicts of interest in situations where they are advisors to both sides of the transaction at the same time.

**(ii) To what extent do you consider proxy advisory firms to already have in place appropriate conflict mitigation measures**

In our experience some proxy advisors don't appear to have appropriate measures in place at all. In fact, the way their business model is currently set up they appear particularly vulnerable to these conflicts of interest. It is our observation that some do not seem to acknowledge the conflict of interest and therefore are not taking active steps to avoid it and with a lack of industry oversight there is no enforcement to suggest that they should.

**(iii) To what extent do you consider proxy advisory firms to be sufficiently transparent regarding the potential conflicts of interests they may face?**

We observe very little transparency in the proxy advisory industry in general. As mentioned in the previous answer our observation is that proxy advisors generally do not appear to acknowledge the conflict of interest that is in place and therefore have not added any level of transparency on the issue.

**6. If you are of the view that there are conflicts of interest within proxy advisory firms that have not been appropriately mitigated, which of these are the most serious in terms of the potential (negative) impact on development of their voting recommendations and why?**

We believe the biggest conflict of interest occurs when an advisor finds themselves advising on both sides of the same vote. We think that the advice provided by proxy advisors would be better served if it were the result of greater consultation with the companies and could provide a little more insight into why a company is behaving the way they are. Where they provide a challenge based on legitimate governance concerns and an understanding of the business it allows the companies to fully address issues and design acceptable plans without encouraging market homogeneity. Similarly, if proxy advisors were to communicate more with their investor clients to determine the key issues that are important to the investor rather than the advisor then they would be able to tailor their voting advice to the specific investors which would maintain a level of investor engagement and also work to reduce the need for market homogeneity.

**7. Should we propose an amendment to NI 51-102 to require reporting issuers to disclose consulting services from proxy advisors in their proxy circular? Or would such disclosure undermine the existing controls and procedures (i.e., “ethical wall”) in place which currently may prevent proxy advisory firm research staff who review an issuer’s disclosure from being made aware of the identity of their firm’s consulting clients?**

In our view CSA should propose an amendment to NI 51-202 to require reporting issuers to disclose consulting services from proxy advisors in their proxy circular. We believe such disclosure requirement is similar in nature to proxy disclosure rules to require new disclosures from companies about their use of compensation consultants and conflicts of interest to address the independence of any compensation advisors.

**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?**

Our perspective is the introduction of any transparency around methodology would be an improvement.

***Issuer engagement***

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

An area of improvement is increasing the communication between proxy advisors and the investors they represent to ensure that voting recommendations represent the intentions of the specific investors rather than a standard and formulaic approach. Furthermore, clear communication of the evaluation policies which proxy advisors use so that they can be appropriately considered by companies at all stages of design and can be the basis for informed dialogue between companies and their investors. Even with clear communication proxy advisors will not always be able to understand the nuances of some strategic decisions and understanding the basis for any voting advice will allow for the company to properly articulate the vision behind any decisions being voted on within the context set forth by the proxy advisor.

Proxy advisors need to spend more time in dialogue with companies to understand the strategic context as part of their assessment process and they need to spend more time in dialogue with investors to understand what the shareowners find to be important assessment points. Ultimately, voting recommendations need to have a clear outline of the issue being voted on, the proxy advisor’s understanding of the company’s strategic rationale for the decision being voted on, a breakdown of the detailed decision criteria and how the proposal either does or does not meet those criteria and then the resultant voting recommendation. Whilst issuers understand that proxy advisors are particularly busy at particular times of year, they often resent the extremely small amount of time they are often given to respond to proxy advisor’s draft reports and to correct any errors of fact.

While we firmly believe that the process of proxy advisory and voting requires more dialogue, we take the position that it is also the responsibility of the investor who relies on these recommendations to enter into this dialogue. Investors have a responsibility to make informed and active voting decisions if they are going to use their votes at all.

**10. During proxy season, is it appropriate for a proxy advisory firm to engage with issuers in all circumstances or are there legitimate business and policy reasons why it should not be required to do so? Are there certain special types of situations where it is more important that issuers are able to engage with proxy advisory firms?**

No comments.

**11. If a proxy advisory firm, as a matter of policy, believes that there are certain circumstances where it is not appropriate for it to give issuers an opportunity to review its reports, would it be sufficient to only require in these circumstances that the underlying rationale for such policy be disclosed? Please explain. Or, alternatively should proxy advisory firms be required to provide issuers with an opportunity to review their reports in all circumstances?**

No comments.

**12. Should we prescribe the details of the processes that proxy advisory firms implement to engage with issuers? If so, what do you suggest the requirements should be?**

In our view CSA should not prescribe the details of the processes that proxy advisory firms implement to engage with issuers. Prescribing the processes would add to the formulaic driven approach that doesn't adequately address organizational concerns and cost/benefit-wise, may involve too high of a cost to do so

#### **Potentially inappropriate influence on corporate governance practices**

**13. To what extent should there be a more fair and transparent dialogue between proxy advisors and market participants on the development of voting policies and guidelines? Is it sufficient for proxy advisors to address governance matters by soliciting comments from their clients?**

It is our experience that the line of communication between proxy advisors and investors could be improved when developing voting policies. The view of many of the investors we spoke with is that proxy advisors should take more of an objective approach to reporting the information and allow the investors to draw their own conclusions. Our view is that we can appreciate the benefit of "outsourcing" the administration around casting votes but that proxy advisors should maintain regular communication with their investor clients and remain flexible in their voting practices to best reflect the wishes of the investors who actually own the shares. Issuers are also concerned at the lack of dialogue, with some voting policies seeming to be grounded more in theory than in the real-world issues that companies face.

*Proposed regulatory responses and framework(s)*

**14. Do you think a securities regulatory response is warranted in connection with each of the concerns identified above? Please explain why or why not.**

No comments.

**15. Do you agree with the suggested securities regulatory responses to each of the concerns raised? If not, what alternatives would you suggest?**

We agreed with the suggested securities regulator responses to each of the concerns raised.

**16. Do you agree or disagree with the requirements and disclosure framework set out in section 5.2.1 to address the concerns identified? If not, please indicate why. Would you prefer instead one of the other suggested securities regulatory frameworks identified above? If so, please indicate why. Do you agree or disagree with our analysis of these frameworks? Do you have suggestions for an alternative regulatory framework?**

We generally agree with the requirements and disclosure framework set out in section 5.2.1 to address the concerns identified. We also agreed with CSA's analysis of the framework.

**17. Are you of the view that we should prescribe requirements in addition to or instead of those identified above for proxy advisory firms?**

In our view CSA should not prescribe requirements in addition to or instead of those identified above for proxy advisory firms.