



Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

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VIA EMAIL

British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial and Consumer Affairs Authority
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Financial and Consumer Services Commission
Superintendent of Securities, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Nunavut

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Re: CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure*

This submission is made by the Pension Investment Association of Canada (PIAC) in response to the request for comments by the Canadian Securities Administrators (the CSA) regarding CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure* (the Consultation Paper), published on August 15, 2013.

PIAC has been the national voice for Canadian pension funds since 1977. Senior investment professionals employed by PIAC's member funds are responsible for the oversight and

management of over \$1 trillion in assets on behalf of millions of Canadians. PIAC's mission is to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries.

PIAC commends the CSA for undertaking this initiative and for its commitment to address concerns regarding the integrity and reliability of the proxy voting infrastructure. As we have stated previously¹, we believe that improvements to the system are long overdue and are critical to the credibility of shareholder votes.

General Observations

PIAC member funds are long-term institutional investors in the Canadian capital markets. Through proxy voting we promote better corporate governance and corporate responsibility with the objective of enhancing issuer performance and shareholder value. Accordingly, we take our voting rights seriously and it is important to us that our voting instructions reach the issuer and that those instructions are given their full weight.

The Consultation Paper identifies two issues that, in the CSA's view, have the most potential to impact the ability of the proxy voting infrastructure to function accurately and reliably. These issues are:

1. Is accurate vote reconciliation occurring within the proxy voting infrastructure?
2. What type of end-to-end vote confirmation system should be added to the proxy voting infrastructure?

We agree that the CSA has focused on the appropriate issues in reviewing the accuracy and reliability of the proxy voting infrastructure and we have provided our responses below to address both issues. The Consultation Paper also identified other issues considered to be relevant to the integrity of the system. As such, we have included our views concerning the impact of the OBO/NOBO concept on voting integrity.

Specific Comments

1. Is accurate vote reconciliation occurring within the proxy voting infrastructure?

PIAC agrees with the assertion in the Consultation Paper that a central function of the proxy voting infrastructure is to facilitate vote reconciliation. Under the book based system, it is most often the case that an intermediary (such as CDS) is the registered holder of the shares and that a series of other intermediaries show those shares on their books as they pass beneficial ownership down the chain to the ultimate investor. Since a single share will be reflected on the records of more than one intermediary, the record keeping practices of the intermediaries (both individually

¹ Letter of Julie Cays, Chair, Pension Investment of Association of Canada to Robert Day, Manager, Business Planning, Ontario Securities Commission (May 29, 2012), available at <http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20120529_11-766_caysj.pdf>.

and as a group) are essential to the integrity of the proxy voting system. In our view, regardless of the number of intermediaries in the chain (each showing a position in the same shares on their books), each share must only be voted once.

As investors, we must rely on the intermediaries individually and collectively to ensure that their records reconcile all of the various entries so that each share is voted only once. If those records have not been properly reconciled, the result may be over-reporting or even over-voting.² We believe that in a properly functioning proxy voting infrastructure, over-voting should never occur because accurately reconciled records at the record date would grant the right to only one person to provide voting instructions with respect to each share.

PIAC acknowledges that there is no consensus in the marketplace about the prevalence of over-reporting (and, consequently, over-voting) in Canada. The Investment Industry Association of Canada (**IIAC**) has stated that over-voting does not materially affect shareholder voting on a widespread basis and its members are able to identify and correct potential over-reporting situations before the voting deadline by using the Over-Reporting Prevention Service (**ORPS**) provided by Broadridge.³ However, we note that Broadridge's service operates only to identify vote totals that are in excess of an intermediary's total CDS position. As a result, routine over-voting may be occurring without ever engaging the ORPS. Moreover, we note that while the ORPS contributes to identifying and correcting over-reporting issues before materials are sent to eligible votes, the fact that there remains a continued need for this service suggests that the problem is systemic.

PIAC is also aware of the voting discrepancies most recently reported by the Securities Transfer Association of Canada (**STAC**), which noted that approximately 51% of meetings from 2013 had occurrences of over-reporting and over-voting.⁴ These findings are alarming and further suggest that over-voting is a systemic problem. The concern is compounded when one considers the expectation that there should usually be a large number of shares that are not voted at any particular meeting since the evidence suggests that only a fraction of retail beneficial owners return voting instruction forms (**VIFs**). We recommend that the CSA investigate and report on the situations causing unresolved over-voting, as reported by STAC.

PIAC is also concerned that the manner in which over-votes are remedied is highly discretionary and opaque. For example, we have been advised that the Broadridge ORPS "pends" any excess

² In this letter, we refer to both over-reporting and over-voting. **Over-reporting** refers to a situation where an intermediary's beneficial ownership records indicate more voting entitlements than are reflected on the records of CDS or DTCC. **Over-voting**, in turn, refers to the situation where more than one vote is cast per vote entitlement. Over-reporting that is not reconciled prior to a meeting may result in over-voting.

³ Letter from Andrea Taylor, Director, Investment Industry Association of Canada to John Stevenson, Secretary, Ontario Securities Commission (March 31, 2011) available at <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_taylor.pdf>. [**IIAC OSC Letter**]

⁴ Letter from William J. Speirs, President, Securities Transfer Association of Canada to the Canadian Securities Administrators in response to CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure* (November 13, 2013), available at <http://www.osc.gov.on.ca/documents/en/com_20131113_54-401_staofcan.pdf>. [**STAC CSA Letter**]

votes received and, unless resolved by the intermediary, the last votes received are not reported to the tabulator. Another common last-minute solution to over-voting is to “pro-rate” the results by reducing the voting position of each shareholder. We believe these discretionary solutions undermine shareholder democracy and are problematic because they are not publicly communicated to a shareholder, which contributes to a lack of integrity and transparency in the proxy voting infrastructure. We believe that meeting tabulators should be required to make publicly available their tabulation processes and related procedures and to disclose their reconciliation method when dealing with voting discrepancies. We understand that Broadridge has also made a similar recommendation.⁵ We also believe that this requirement to disclose reconciliation methods used should be extended to intermediaries who have received a notification from Broadridge’s ORPS.

(a) What contributes to reconciliation problems?

The Consultation Paper identifies three issues that may cause reconciliation problems, two of which (securities lending and restricted proxies) that may lead to over-voting and one (omnibus proxies) that may lead to validly cast votes being improperly discarded by the tabulator. We have responded to each in turn.

(i) Impact of securities lending on generating voter lists

Securities lending is often cited as creating an opportunity for a share to be voted more than once. PIAC acknowledges that there is no agreement in the marketplace about whether this opportunity exists largely in theory or whether it is an issue that should be of concern to issuers and investors. This lack of agreement supports the need for involvement of the CSA to drill down and undertake a comprehensive review of securities lending practices and their potential impact on voting so that it is apparent to the marketplace the extent to which a problem exists (if at all).

We understand that the standard industry procedure adopted by IIAC member firms dictates that the lender is the beneficial holder of shares on loan and is entitled to vote. However, industry agreements provide that the lender will be allowed to vote lent shares only if the broker-dealer can obtain a broker proxy or an omnibus proxy (from the borrower). If the dealer is unable to obtain such a proxy, the record date position held by the lender will be adjusted to reduce the shares on loan.⁶

PIAC member firms have also discussed the securities lending issue with the custodians who they retain. Those custodians have explained the processes they use in order to ensure securities

⁵ Letter from Patricia Rosch, President, Broadridge Investor Communication Solutions, International to the Canadian Securities Administrators in response to CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure* (November 13, 2013), available at <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20131113_54-401_bfsinc.pdf>.

⁶ IACC OSC Letter, *supra* note 3 at 10-11.

lending programs which they administer do not contribute to over reporting, as they pre-reconcile their records before any proxy mailing.

We recommend that the CSA consider whether IIAC members and the custodians are the only parties who administer securities lending programs. The CSA should obtain empirical data from IIAC and from the custodian community (and anyone else who administers securities lending programs) to satisfy themselves that securities lending programs run by these organizations do not give rise to over-reporting and over-voting issues that could be material for any particular shareholder meeting. The CSA should then disclose its conclusions and advise what, if any, remedial regulation it proposes.

(ii) Restricted proxies

As a result of internal consultations, PIAC understands that, while the use of restricted proxies has decreased, they may still create issues related to tabulating votes. One example provided by a transfer agent occurs when a restricted proxy is requested by a shareholder (most often a large holder and sometimes an insider of the issuer) so they can vote directly or attend the meeting in person. In these circumstances, the shareholder would contact their broker-dealer who would give that account holder a restricted proxy that allows them to vote, either by submitting it to the tabulator or by attending the meeting in person. Broadridge has no role in issuing restricted proxies and would not know whether a restricted proxy was issued. The broker-dealer is responsible for recording the fact they have granted a restricted proxy and making the adjustments necessary to the records sent to Broadridge. Issues may arise if the broker-dealer has not appropriately adjusted the account to reflect that a restricted proxy was issued. We recommend that the CSA investigate how often tabulation issues related to the issuance of restricted proxies occur.

(iii) Omnibus proxies

We understand that the way in which voting instructions are handled is somewhat different from what is contemplated in National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* (NI 54-101). NI 54-101 contemplates proxy materials being passed from one intermediary to another until they reach the ultimate investor and then the investor's voting instructions being passed back up the chain until it reaches the intermediary who holds the proxy issued to it by the registered holder (CDS in many cases). However, very often an intermediary in the chain sends the voting instructions from its clients directly to Broadridge. This requires that a mini-omnibus proxy be issued in favour of that intermediary.

We understand that several problems can arise in connection with mini-omnibus proxies. The mini-omnibus proxy may not be issued if the records of the intermediary who must issue that document are not properly coded. This issue should be addressed together with other issues related to the books and records of the intermediaries raised in this response. In addition, the situation may be further complicated by the continued use of paper omnibus proxies that are transmitted by fax or through the use of .pdf files, as a result of the different technology platforms used by various market participants. While we do not have quantitative data to determine exactly how often these issues arise, anecdotally we understand that these issues are

not uncommon.⁷ We recommend that the CSA encourage and facilitate the adoption of electronic file transmission of this data.

(b) What solutions should be implemented to address vote reconciliation problems?

(i) Early reconciliation of voting entitlements should be mandated

PIAC believes securities regulators should publish for comment amendments to NI 54-101 requiring that all intermediaries implement “pre-mailing” reconciliation practices in respect of all meetings to prevent over-reporting issues. The integrity of shareholder meetings can only be assured if proxy materials and a request for voting instructions are sent only to eligible voters. As described above, securities lending by intermediaries and other factors, such as missing omnibus proxy documentation and the issuance of restricted proxies, may lead to reconciliation problems resulting in over-reporting and over-voting.

The failure of intermediaries to maintain appropriate records and to follow appropriate internal processes may result in the number of shares credited on their books as exceeding their total CDS position. We believe that improvement in the effectiveness of the proxy voting infrastructure must start with more accountability from intermediaries for reconciling the files of beneficial ownership data with their registered, depository and nominee positions as of the record date, in order to avoid distributing proxy materials to ineligible beneficial owners and to avoid discrepancies in tabulating final vote counts.

(ii) All participants in the proxy voting infrastructure should be subject to securities regulation and held accountable

As noted in the Consultation Paper, numerous service providers are utilized by issuers and investors in connection with the proxy voting infrastructure. These parties include depositories, transfer agents, intermediaries, proxy agents, proxy solicitors and proxy advisory firms. Moreover, some of these parties can play multiple roles within the system: for example, transfer agents frequently act as tabulators and scrutineers at shareholder meetings.

PIAC believes the CSA should conduct an independent operational audit of the proxy voting infrastructure. While each of the service providers makes a significant contribution to the operation of the system, they are also heavily invested in the current model and in any changes that might be made to that model. We believe an independent audit is necessary because there are multiple participants involved in the system and not one body has complete access to information regarding, or control over, significant portions of the system to assess the reliability of the proxy voting infrastructure as a whole. We recognize that an independent audit to assess the effectiveness of the proxy voting infrastructure will require a significant expenditure of financial and human resources; however without such a review we do not believe that the CSA

⁷ STAC has most recently reported that the combination of over-voting and missing omnibus documentation result in votes for more than an estimated two billion shares annually not being counted. STAC CSA Letter, *supra* note 4 at 5.

can unequivocally assure the marketplace that the proxy system is functioning with reliability and integrity. We believe that this assurance is sufficiently important that steps should be taken to identify appropriate sources of funding to undertake this audit. PIAC has also proposed two immediate solutions that securities regulators can implement to support market confidence that the proxy infrastructure system is working as it was intended.

Initially, PIAC believes that securities regulators should be responsible for the oversight of all service providers whose functions are integral to the effectiveness of the proxy voting infrastructure. While certain service providers are currently subject to some degree of regulation, no single regulator can access information about all major participants. We consider this to be problematic, as it makes regulatory monitoring of compliance within the system difficult if not impossible. As such, we recommend that all major service providers be designated as “market participants” within the meaning of securities legislation.

Secondly, PIAC suggests that each financial intermediary subject to NI 54-101 (including proximate intermediaries) be required to file a quarterly certification indicating that the intermediary has reconciled their beneficial ownership information to their depository record date positions as of the record date provided by the issuer and has submitted files containing only the positions of holders entitled to vote as of the record date. We believe that this requirement for a quarterly confirmation would further the current guidance in section 4.3 of 54-101CP and will greatly assist in ensuring that only those beneficial owners entitled to vote receive a VIF. This will, in turn, facilitate the reduction of the occurrences of over-voting. While there are general enforcement and remedial provisions available under securities legislation, there are no specific enforcement mechanisms or consequences for non-compliance with NI 54-101 and, consequently, we believe there is a lack of focus and enforcement with respect to these requirements. We believe that a more cost effective solution would be to impose these compliance requirements on intermediaries who are already subject to NI 54-101.

Similar to the regulatory approach taken in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* for reporting issuers, the certification requirement would require intermediaries to disclose their conclusions about the effectiveness of their reconciliation policies and practices and remediate any control deficiencies. We submit that intermediaries would not be held up to a standard of perfection as the certificate could reflect that the intermediary has designed systems to provide “reasonable assurance” that their beneficial ownership information is accurate and reconciled for each applicable record date. We believe this requirement would cause the compliance departments within the intermediaries to turn their minds to the issue of compliance with NI 54-101 on a regular basis and, in many cases, in advance of any potential late-stage over reporting situations.

(c) What type of end-to-end vote confirmation system should be added to the proxy voting infrastructure?

PIAC's member funds currently use a variety of methods and services to access the proxy voting infrastructure. However, such services do not routinely provide any degree of confirmation that the voting instructions our member funds submit have been received and properly recorded by the tabulator at the shareholder meeting. We believe that the lack of an end-to-end vote confirmation functionality undermines confidence in the accuracy and reliability of proxy voting

results for beneficial owners. While the current private sector initiatives to provide an end-to-end vote confirmation solution are commendable, PIAC believes that any meaningful end-to-end vote confirmation system should be mandated in all circumstances, regardless of Broadridge's involvement, so as to permit all investors to determine that their votes have been given their full weight at a shareholder meeting.

PIAC believes that a meaningful end-to-end vote confirmation system must have the six following essential features:

- Vote confirmation must be provided to the ultimate investor casting the vote, not to the financial intermediary or nominee through which the beneficial owner holds the shares;
- Vote confirmation must be transmitted electronically to investors, not in a paper-based format;
- Vote confirmation must be sent to the investor at the three following stages in the voting process:
 - The voting instructions have been received by the tabulator
 - The voting instructions have been accepted and processed by the tabulator, as instructed by the investor, and
 - The voting instructions have been confirmed as voted at the shareholder meeting;
- Voter anonymity must be preserved for all votes cast;
- The end-to-end vote confirmation system must be practical, accessible and compatible for investors that use third-party service providers to access their meeting materials and vote electronically; and
- The end-to-end vote confirmation system must be auditable.

PIAC understands that Broadridge is currently offering an end-to-end vote confirmation functionality for issuers in the U.S. However, in its current form, the issuer must request the end-to-end functionality at its shareholder meeting, and this functionality relies on Broadridge being appointed the “master” tabulator for the meeting by the issuer, which includes distributing materials to both registered and beneficial owners and tabulating the votes received from them. We are not aware of any Canadian reporting issuer, as of this time, as having designated Broadridge to act as “master” tabulator for a shareholder meeting.

We believe that vote confirmation by investors should not rely on opt-in by the issuer. We understand that, of the approximately 1,900 U.S. issuers who have appointed Broadridge as a tabulator, only six reporting issuers in the U.S. have elected to use Broadridge's end-to-end vote confirmation service for the upcoming proxy season.

We have also been advised that Broadridge is extending its service to other transfer agents in the U.S. through a pilot initiative for the 2014 proxy season with approximately 20 issuers.

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However, there are some issues that need to be addressed, such as implementing new IT communication tools that deliver acceptance and rejection data and a description of the issue(s) behind any rejection before an end-to-end vote confirmation functionality can be broadly adopted by issuers in the U.S. and successfully implemented in Canada. In addition, not all of our member funds use ProxyEdge® to manage their proxy processes. For example, many member funds utilize the services of Institutional Shareholder Services Inc. or Glass, Lewis & Co., which operate proprietary electronic platforms for managing client proxy services. However, such services are ultimately reliant on data feeds from Broadridge and other providers, and therefore cannot provide any greater degree of confirmation than is available through ProxyEdge®. Any end-to-end vote confirmation system must be assessable and compatible to those services.

Are there any specific instances where the existence of the OBO/NOBO concept has compromised the accuracy and reliability of proxy voting?

We note the current debate concerning the ability for shareholders to conceal their personal and proprietary information from an issuer by designating themselves as an “objecting beneficial owner” (or **OBO**) rather than a “non-objecting beneficial owner” (or **NOBO**). PIAC believes this debate is occurring in the context of “shareholder communication”, with a focus on the ability of an issuer to identify its shareholders and to contact those investors directly. In contrast, the questions raised in the Consultation Paper do not address shareholder communication; instead the CSA has commenced its review to consider the integrity of the proxy voting infrastructure. While the manner of shareholder communication (and the corresponding level of investor transparency) remains an important question, we believe this question should be examined separately.

Some commenters have argued that the OBO/NOBO distinction adds a layer of complexity to the system. However, there is no evidence that this distinction itself is an impediment to an efficient and reliable proxy voting infrastructure. We believe that the removal of the OBO/NOBO distinction would only marginally reduce the complexity of the system, as a significant degree of that complexity can be attributed to the use of “intermediation,” and its inherent multiple layers of beneficial holding. Even in the absence of the OBO designation, any efforts made by a reporting issuer to determine the identity of its shareholders as of a particular record date would still require the cumbersome process of searching the records of each intermediary, and those intermediaries would still need to reconcile their own records against those provided by intermediaries further up the chain of ownership. From a proxy voting process perspective, the removal of the OBO concept would simply assist issuers in that, once the identity of the investors were determined, issuers would be free to mail their proxy materials through their own transfer agents (or other third parties), presumably at a cost savings over using Broadridge to deliver the same material.

However, any such marginal reduction in the complexity of the system or potential cost savings to the issuers must be weighed against the potential costs and loss of efficiency to the market and to its participants. PIAC’s member funds regard the privacy enjoyed by them as a result of the OBO/NOBO distinction as significant. The current distinction affords a degree of anonymity considered essential to protect their proprietary trading strategies from competitors or from others who may attempt to “front run” their strategies, as well as from other adverse impacts on a

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share's price that may result from their identity as an investor being known. In some cases, the success of these strategies depends on this anonymity. Moreover, the shareholder list is prepared once a year, specifically for voting purposes, and may not reflect the extent of all economic exposure an investor may have to an issuer. The loss of the OBO/NOBO distinction may result in costs to PIAC's member funds and other institutional investors who may choose to restructure and maintain their holdings through nominee accounts in order to continue to preserve their anonymity. Alternatively, they may review and reassess certain of their investment strategies in light of the loss of anonymity.

PIAC submits that maintaining the OBO/NOBO distinction does not stand in the way of reforms to the system. We note that measures such as mandatory pre-mailing reconciliations by intermediaries would not require a change to the OBO/NOBO system. Similarly, we understand that the implementation of an end-to-end vote confirmation system would not necessarily require OBOs to disclose their identity. By way of example, an end-to-end vote confirmation system that was considered at the Weinberg Centre Roundtable on Proxy Voting would utilize confidential control numbers instead of names to identify the appropriate investors and their accounts.⁸

Thank you again for this opportunity to comment on the Consultation Paper. Please do not hesitate to contact Stéphanie Lachance, Chair of the Corporate Governance Committee (514-925-5441; slachance@investpsp.ca), if you wish to discuss any aspect of this letter in further detail.

Yours sincerely,



Brenda McInnes
Chair

⁸ The University of Delaware's John L. Weinberg Center for Corporate Governance convened a roundtable on proxy voting convened and published a report (the **Report**) setting out recommendations for providing end-to-end vote confirmation. The Report mentioned that, in developing vote confirmation functionality through electronic means, the process could be accomplished by the use of secure websites with security protections and other controls to maintain confidentiality.

See University of Delaware, "Report of Roundtable on Proxy Governance: Recommendations for Providing End-to-End Vote Confirmation" (August 2011), available at <<http://www.sec.gov/comments/s7-14-10/s71410-300.pdf>>.