



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

**TOM QUAADMAN**  
VICE PRESIDENT

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

June 20, 2014

British Columbia Securities Commission  
Alberta Securities Commission  
Financial and Consumer Affairs Authority of Saskatchewan  
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Financial and Consumer Services Commission of New Brunswick  
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Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Superintendent of Securities, Yukon Territory  
Superintendent of Securities, Northwest Territories  
Superintendent 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

The Secretary  
Ontario Securities Commission  
20 Queen Street West  
22<sup>nd</sup> Floor  
Toronto, Ontario M5H 3S8

**Re: National Policy 25-201, *Guidance for Proxy Advisory Firms***

Dear Me. Beaudoin and to Whom It May Concern:

The U.S. Chamber of Commerce (“Chamber”) is the world’s largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber formed the Center for Capital Markets Competitiveness (“CCMC”) to promote a modern and effective regulatory structure for capital markets to fully function in a 21<sup>st</sup> century economy. It is an important priority of the CCMC to advance an effective and transparent corporate governance system that encourages shareholder communications and participation.

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The CCMC appreciates the efforts by the Canadian Securities Administrators' ("CSA") and welcomes the opportunity to comment on the CSA's Proposed National Policy 25-201, Guidance for Proxy Advisory Firms ("Proposed Guidance").<sup>1</sup> We believe that it is imperative that transparency, disclosure, and accountability are the cornerstone of providing objective proxy advice that meets the needs and duties of the clients of proxy advisory firms. Such a system of oversight, which can be accomplished through guidance and voluntary efforts of the proxy advisory firms, will prevent conflicts of interest and help ensure that proxy advice is factually accurate and objective.

### Discussion

With the number of investments institutional investors must make to advance their investors' interests, proxy advisory firms play an important role in facilitating those funds' fulfillment of their duties as informed participants in the corporate governance process. The CCMC commends CSA's initiative to provide guidance outlining reasonable expectations for proxy advisory firms' conduct, an important first step in bringing greater transparency and accountability to the proxy advisory industry dominated by two firms, Institutional Shareholder Services ("ISS") and Glass, Lewis & Co. ("Glass Lewis"). These two firms collectively control 97% of the market for proxy advisory services,<sup>2</sup> and their proxy voting recommendations influence up to 38% of the votes cast on many company proxy issues.<sup>3</sup> Moreover, these two firms' tremendous influence over corporate governance is felt even prior to any vote, as corporate planners feel compelled to obtain their positive vote recommendation, whether or not they agree with the firms' underlying policies.<sup>4</sup>

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<sup>1</sup> Canadian Securities Administrators, National Policy 25-201, *Guidance for Proxy Advisory Firms* (Apr. 24, 2014) ("Proposed Guidance"), available at: [http://www.albertasecurities.com/Regulatory%20Instruments/4818140-v1-CSA\\_Note\\_and\\_Request\\_for\\_Comment\\_Proposed\\_NP\\_25-201\\_.pdf](http://www.albertasecurities.com/Regulatory%20Instruments/4818140-v1-CSA_Note_and_Request_for_Comment_Proposed_NP_25-201_.pdf).

<sup>2</sup> See J. Glassman & J. Verret, *How to Fix our Broken Proxy Advisory System*, Mercatus Center, George Mason Univ., at p. 8 (Apr. 16, 2013), available at [http://mercatus.org/sites/default/files/Glassman\\_ProxyAdvisorySystem\\_04152013.pdf](http://mercatus.org/sites/default/files/Glassman_ProxyAdvisorySystem_04152013.pdf).

<sup>3</sup> See Y. Ertimur, F. Ferri & D. Oesch, Shareholder Votes and Proxy Advisors: Evidence from Say on Pay, 7th Ann. Conf. on Empirical Legal Studies Paper (Feb. 25, 2013), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2019239](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019239).

<sup>4</sup> A 2011 Conference Board survey found that 72% of companies reviewed the policies of proxy advisory firms, or engaged with these firms, to obtain guidance on their executive compensation plans, and 70.4% reported that their compensation programs were influenced by proxy advisory firm guidance. See D. Larcker, The Conference Board Director Notes, *The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation*

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Despite wielding the influence of *de facto* corporate governance standard setters, proxy advisory firms have steadfastly refused to provide transparency into their own policymaking and vote recommendation processes, and they fervently eschew any efforts to make themselves accountable for the consequences of their policy pronouncements and vote recommendations. The lack of transparency and accountability of proxy advisory firms undermines confidence in, and stalls the progress of, strong corporate governance.<sup>5</sup> The impact of proxy advisory firms has become even more pronounced as the number and complexity of issues on proxy ballots have grown.<sup>6</sup> And yet, proxy advisors have not taken meaningful steps to ensure their voting recommendations are developed based on clear, objective, and empirically-based corporate governance standards to help management and investors evaluate and improve portfolio companies' corporate governance as a means of increasing shareholder value.<sup>7</sup>

CCMC believes that government regulators should encourage public companies, investors and proxy advisory firms to engage in a constructive dialogue to ensure a proxy voting system that advances the economic interests of shareholders,

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*Decisions*, (2012) at p. 4, available at <https://www.gsb.stanford.edu/sites/default/files/documents/TCB-DN-V4N5-12%20Proxy%20Survey%20results.pdf>.

<sup>5</sup> See Securities and Exchange Commission ("SEC") Proxy Advisory Firm Roundtable, Remarks of Hoil Kim, Vice President, Chief Administrative Officer and General Counsel of GT Advanced Technologies, at pp. 137-38 (Dec. 5, 2013) ("SEC Roundtable"), transcript available at <http://www.sec.gov/spotlight/proxy-advisory-services/proxy-advisory-services-transcript.txt> ("[E]very minor signal that comes out of ISS or Glass Lewis is completely over read, and so the compensation committees in particular are looking over their shoulders at every possible indication that comes out, and the rationale, and it's not the transparency of what the policy is but what the process is and what the rationale might be. And . . . we have to ask whether the way we collectively have caused the system to operate is encouraging that or discouraging that.").

<sup>6</sup> For example, in the U.S., recent legislation ushered in advisory votes on executive compensation ("say-on-pay") on a nearly universal basis. See Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFA"), Pub. L. No. 111-203, 124 Stat. 1376, §951 (2010). DFA dramatically increased the already-significant workload of those responsible for institutional proxy voting. Moreover, between 2006 and 2011, the average length of proxy statements of Dow 30 companies grew by 54%, from 46 to 71 pages. See H. Gregory, Weil, Gotshal & Manges, LLC, *Innovations in Proxy Statements*, at p. 1 (Jul/Aug 2012), available at [http://www.weil.com/files/upload/July-August2012\\_Opinion.pdf](http://www.weil.com/files/upload/July-August2012_Opinion.pdf).

<sup>7</sup> Some academic research suggests that proxy advisory firms' favored corporate governance policies are negatively correlated with shareholder value. See D. Larker, A. McCall & G. Ormazabal, *The Economic Consequences of Proxy Advisor Say-on-Pay Voting Policies*, Stanford Grad. Sch. of Bus. Res. Paper No. 2105 (Jul. 5, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2101453](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2101453). Thus, votes cast in accordance with these policies are often antithetical to portfolio managers' acknowledged fiduciary duties. See, e.g., Inst'l Sh. Services Inc., SEC Staff No-Action Letter, at pp. 14-15 (Jan. 2, 1991) (copy is attached) ("The importance and the obligations and liability of fiduciaries are exactly the same for investment decisions as for proxy voting decisions.").

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the ultimate owners of all corporations. To that end, and as part of an ongoing effort to initiate constructive dialogue, CCMC released its *Best Practices and Core Principles for the Development, Dispensation, and Receipt of Proxy Advice* (“*Chamber Principles*”), which discussed the applicable principles, and best practices, for all principal stakeholders in the corporate governance process, including proxy advisory firms, public companies and asset managers.<sup>8</sup> The CSA’s Proposed Guidance provides a critical foundation for a constructive dialogue regarding the conduct of proxy advisory firms and their appropriate role in the marketplace, and we support CSA’s assessment that issues presented by proxy advisory firms, as well as the effects of their policy pronouncements and vote recommendations, warrants guidance.<sup>9</sup> While we agree with a non-prescriptive approach, it is appropriate to highlight that the two dominant proxy advisory firms—ISS and Glass Lewis—have repeatedly resisted such efforts.

For example, in 2011, France’s Autorité Des Marchés Financiers (“AMF France”) issued AMF Recommendation No. 2011-06 (“AMF Recommendation”),<sup>10</sup> which called on proxy advisory firms voluntarily to adopt robust measures to address their conduct in four areas:

- Establishing and issuing voting policies;
- Establishing and submitting vote recommendations to investors;
- Communicating with listed companies, and;

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<sup>8</sup> See U.S. Chamber of Commerce, BEST PRACTICES AND CORE PRINCIPLES FOR THE DEVELOPMENT, DISPENSATION, AND RECEIPT OF PROXY ADVICE (Mar. 2013), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf>. Despite being recognized, including by the current Chair of the Securities and Exchange Commission, as a constructive addition to the broader dialogue concerning the role of proxy advisory firms and others in the corporate governance process, to date neither ISS nor Glass Lewis have engaged in any effort to discuss or implement the *Chamber Principles*. See Remarks of SEC Chair Mary Jo White at the 8<sup>th</sup> Annual Capital Markets Summit, Washington, DC (Mar. 19, 2004) (“Chair White Capital Markets Summit Comments”), available at <https://www.uschamber.com/event/8th-annual-capital-markets-summit>.

<sup>9</sup> Proposed Guidance, *supra* n. 2 at pp. 4339-40.

<sup>10</sup> Autorité Des Marchés Financiers, AMF Recommendation 2011-06, Proxy Voting Advisory Firms (Mar. 18, 2011) (“AMF Recommendation”), available at [http://www.amf-france.org/en\\_US/Reglementation/Dossiers-thematiques/Societes-cotees-et-operations-financieres/Gouvernement-d-entreprise/Les-recommandations-de-l-AMF-sur-les-agences-en-conseil-de-vote.html](http://www.amf-france.org/en_US/Reglementation/Dossiers-thematiques/Societes-cotees-et-operations-financieres/Gouvernement-d-entreprise/Les-recommandations-de-l-AMF-sur-les-agences-en-conseil-de-vote.html).

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- Preventing conflicts of interest.

In response, ISS and Glass Lewis each took minimal, superficial, steps outlined in the AMF Recommendation,<sup>11</sup> touting them publicly in press releases, without addressing the spirit or intent of the AMF Recommendation.<sup>12</sup> Therefore, we urge the CSA to continue to devote appropriate time and attention to monitoring proxy advisory firms' adherence to the letter and spirit of the Proposed Guidance.

#### **a. Conflict of Interest Management, Mitigation and Disclosure**

CSA has taken a comprehensive approach to the identification, management, mitigation and disclosure of proxy advisory firm conflicts of interest.<sup>13</sup> Actual and apparent conflicts have been, and continue to be, a major concern that is shared by a broad array of stakeholders in the corporate governance process. For example, representatives of various stakeholders with conflicting views on many issues all voiced identical concerns about proxy advisory firms' conflicts of interest at a December 2013 SEC Roundtable on Proxy Advisory Firms,<sup>14</sup> and the issue has been

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<sup>11</sup> Both proxy advisory firms make their reports available to subject companies following release to clients, although AMF's recommendation was to make reports available to companies for *pre-publication* review. See ISS, ISS Updates Compliance with AMF Recommendation No. 2011-06 of March 18, 2011 on Proxy Advisory Firms (Mar. 2012), available at <http://www.issgovernance.com/policy/FrenchDraftReviewAnnouncement>. See also Glass, Lewis, *AMF Recommendation for Proxy Advisors*, available at <http://www.glasslewis.com/issuer/amf/>.

<sup>12</sup> AMF Recommendation, *supra* n. 11. See also, Tom Quaadman, *We Will Always Have...Proxy Advisory Firms?*, Free Enterprise (Dec. 5, 2012), available at <http://www.freeenterprise.com/capital-markets/we-will-always-have-proxy-advisory-firms> (observing the broad discrepancies between AMF's recommendations and ISS' and Glass Lewis' practices).

<sup>13</sup> Proposed Guidance, *supra* n. 2, at Part 2.1. The CSA has endorsed a similar approach to credit rating agency conflicts of interest, see CSA Notice, National Instrument 25-101, Designated Rating Organizations, Related Policies and Consequential Amendments, Appendix A, "Independence and Conflicts of Interest" (Jan. 27, 2012) ("CSA Credit Rating Release"), available at [http://www.osc.gov.on.ca/documents/en/Securities-Category2/rule\\_20120127\\_25-101\\_amd-designated-rating.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category2/rule_20120127_25-101_amd-designated-rating.pdf).

<sup>14</sup> See, e.g., SEC Roundtable, Remarks of Anne Sheehan, Dir. of Corp. Gov., CalSTRS, *supra* n. 6 at pp. 106-07 ("In terms of disclosure ... [these firms] could be more transparent and [make their disclosures] more prominent. . . ."); Damon Silvers, Dir. of Policy and Spec. Counsel, AFL-CIO, at pp. 127-28 ("[T]he business model of having consulting services provided to issuers and at the same time providing proxy advisory services to investors . . . is inappropriate . . . . [W]here a proponent of a resolution is a client, that that ought to be disclosed. . . ."). See also N. Minow, *ISS May Be Under Fire, but Look How Far It—and Shareholder Rights—Have Come* (Mar. 16, 2011), available at <http://www.cbsnews.com/news/iss-may-be-under-fire-but-look-how-far-it-and-shareholder-rights-have-come/> ("In my opinion, though, ISS really shouldn't do consulting work for companies it covers. I didn't allow it when I was CEO of ISS, and I didn't allow it at The Corporate Library.").

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identified—both by Members of the U.S. Congress with jurisdiction over corporate governance issues, as well as by the Current SEC Chair—as a priority for the proxy advisory industry.<sup>15</sup>

In addition to CSA’s expectation that proxy advisory firms maintain policies and procedures reasonably designed to detect and mitigate actual and apparent conflicts of interest, set a culture of compliance with respect to conflicts of interest, ensure that the CEO and board of directors (or equivalent body) are responsible for ensuring compliance with such policies, and posting such policies on a publicly available website, we suggest the CSA update its Proposed Guidance to provide that:

- All potential and *actual* conflicts be disclosed clearly and with specificity on the front page of advisory firm reports; and
- Advisory firm personnel responsible for doing factual research and formulating recommendations should attest to their independence and the due diligence they performed vis-à-vis the facts and recommendations therein.

Similar conflict disclosures have effectively been utilized in the U.S. and Canada vis-à-vis investment research analysts that, like proxy advisory firms, should make detailed disclosures to alert the recipients of their efforts that they are beholden to interests that may compromise the independence and integrity of the advice they render to otherwise unsuspecting investors.<sup>16</sup> The specificity and accountability (both at an individual and institutional level) we recommend contrasts sharply from ISS’ and

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<sup>15</sup> See Letter from ten Members of Congress to SEC Chair Mary Jo White (Mar. 18, 2014), available at <http://www.sec.gov/comments/4-670/4670-14.pdf>. See also, Chair White Capital Markets Summit Comments, *supra* n. 9.

<sup>16</sup> SEC Adopting Release, Regulation Analyst Certification (Apr. 14, 2003), available at <http://www.sec.gov/rules/final/33-8193.htm>. See also, Investment Dealers Association of Canada, Dealer Member Rules, Rule 3400, “Research Restrictions and Disclosure Requirements,” available at [http://iiroc.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=201405341&tocID=848#para\\_4](http://iiroc.knotia.ca/Knowledge/View/Document.cfm?Ktype=445&linkType=toc&dbID=201405341&tocID=848#para_4) (requiring, at a minimum, “clear, comprehensive and prominent [disclosure of potential conflicts of interest]. Boilerplate disclosure is not sufficient.”).

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Glass Lewis' current practices, which vary from non-existent to vague, non-committal, and inaccessible.<sup>17</sup>

Similarly, the SEC requires registered credit rating agencies to maintain a website containing information pertinent to its rating, and permit access to that data by other credit rating agencies solely for the purpose of issuing their own ratings.<sup>18</sup> In adopting that requirement, the SEC emphasized that provisions of this type “address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products.”<sup>19</sup> Given the proxy advisory industry's dominance by only two firms, each mired in substantial conflicts of interest recognized by the CSA, the impetus for creation of a similar system in the context of the proxy advisory industry is even more compelling than that for credit rating agencies.

#### **b. Designated Conflicts Managers**

CCMC applauds CSA's recognition of the need for proxy advisory firms to designate “appropriately qualified” persons (“Conflicts Managers”) to monitor and assess compliance, the appropriateness of internal safeguards and controls, and periodically to report to the CEO or board of directors (or equivalent body) of the proxy advisory firm. To insure their effectiveness, Conflicts Managers should be independent, and required to report any concerns they may have up the ladder of each proxy firm's chain of command.<sup>20</sup> Specifically, Conflicts Managers should be required

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<sup>17</sup> ISS indicates on the back page of its research reports that it may have conflicts of interest not disclosed in the report, and that its clients may request further information concerning potential conflicts resulting from its issuer consulting business. *See, e.g.*, ISS, Research Report on The Western Union Company, at p. 26 (May 13, 2013), available at [http://www.issgovernance.com/file/2013/02/western\\_union.pdf](http://www.issgovernance.com/file/2013/02/western_union.pdf). ISS does not disclose whether the proponent of a shareholder proposal, competing director slate, or “vote no” campaign is a client, nor does it consistently disclose whether any other party has attempted to influence the outcome of its vote recommendations. Glass Lewis provides limited disclosure in its research reports, and the guidelines it applies to disclosure of actual and potential conflicts are vague, and made available only upon request to Glass Lewis. *See* Glass Lewis, *Conflict of Interest Statement*, available at <http://www.glasslewis.com/about-glass-lewis/disclosure-of-conflict/>.

<sup>18</sup> *See* SEC Rule 17g-5, 17 CFR §240.17g-5 (2014), available at <http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=fcb0046d2c225b4e99b3eaf364eb8469&r=PART&n=17y4.0.1.1.1#17:4.0.1.1.2.105.446>.

<sup>19</sup> *See* Adopting Release, Amendments to Rules for Nationally Recognized Statistical Rating Organizations, at p. 74 (Feb. 2, 2010), available at <http://www.sec.gov/rules/final/2009/34-61050.pdf>.

<sup>20</sup> This approach is required of corporate attorneys who practice before the SEC. *See* SEC, Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer, 17 C.F.R.

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to report unmitigated/undisclosed material conflicts by proxy advisory firms (or their agents) to the firm's CEO or chief legal officer and, thereafter, to the highest authority within the firm, if initial reports do not yield appropriate responses.<sup>21</sup>

As suggested by question #4 of the CSA's Proposed Guidance,<sup>22</sup> Conflict Managers should also maintain, review and implement policies and procedures for determining vote recommendations (and disputes related thereto), developing proxy voting guidelines and proxy advisory firms' communications with clients,<sup>23</sup> issuers<sup>24</sup> and the public,<sup>25</sup> as well as the firms' owners and affiliates,<sup>26</sup> with respect to all situations that present proxy advisory firms and their personnel with significant

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§§205.1-7 (2014), available at <http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=fcb0046d2c225b4e99b3eaf364eb8469&r=PART&n=17y3.0.1.1.6>. The CSA has endorsed similar reporting and independence requirements for Compliance Officers of credit rating agencies, *see* CSA Credit Rating Release, *supra* n. 14, at Part 5, "Compliance Officer."

<sup>21</sup> *See generally*, Implementation of Standards of Professional Conduct for Attorneys, (Aug. 5, 2003), available at <http://www.sec.gov/rules/final/33-8185.htm>.

<sup>22</sup> Proposed Guidance, *supra* n. 2, at p. 4343.

<sup>23</sup> SEC Roundtable, *supra* n. 6, Remarks of Anne Sheehan, at p. 108 ("So our issue is put it out there that we're the proponent and we are clients of both of them, and let people take that information and sort of digest it as they will."); Remarks of Damon Silvers, at pp. 127-28 ("[W] here a proponent is a client of a resolution, that ought to be disclosed. . . . The reason for it, frankly, is that, you know, funds that are in one way or another that AFL-CIO members participate in and are offering proponents, *and we want a level playing field?*") (emphasis supplied).

<sup>24</sup> In response to the suggestion that ISS' consulting business presents a conflict of interest because its business model is predicated upon offering access to non-public information concerning the vote recommendations of ISS' shareholder advisory business, ISS President Gary Retelny remarked, "They are, in fact, trying to drum up business, I believe. They are in the consulting business, after all . . . ." *See* SEC Roundtable, *supra* n. 6, at pp. 123-24.

<sup>25</sup> While SEC Rule 14a-2(b)(3), 17 C.F.R. §240.14a-2(b)(3) (2014), available at <http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=fcb0046d2c225b4e99b3eaf364eb8469&r=PART&n=17y4.0.1.1.1#17:4.0.1.1.2.87.220>, provides an exemption—from the SEC's general requirement that those who participate in the solicitation of proxies pre-file soliciting materials with the SEC before distributing them—for proxy voting advice furnished to clients by financial advisors, the rationale underlying the exemption should be revisited, given CSA's accurate observation that the public has a legitimate interest in corporate governance and proxy voting, *see* Proposed Guidance, *supra* n. 2 at p. 4342, the collective nature of proxy voting, and the fact that proxy advisory firms have increasingly taken aggressive stances on public policy issues with broad public policy ramifications. *See generally*, CCMC letter to Gary Retelny, ISS President, regarding "ISS Benchmark Policy Consultation—Auditor Rotation," as transmitted to SEC Chair White (Feb. 24, 2014), available at <http://www.sec.gov/comments/4-670/4670-12.pdf> (discussing ISS' proposal to impose *de facto* audit firm rotation on public companies, despite numerous and extensive reviews by U.S. regulators and policymakers concluding that mandatory rotation would not produce net benefits).

<sup>26</sup> Glass Lewis' majority owner, the Ontario Teachers' Public Pension, communicates activist stances with regard to companies held in its portfolio, in some cases prior to the release of Glass Lewis vote recommendations concerning the same companies. *See* Letter from Tom Quaadman to Assistant Secretary of Labor Phyllis Borzi (June 25, 2012), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-6.25-DOL-Letter-re-Glass-Lewis-Canadian-Pacific.pdf>.

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potential conflicts. Moreover, Conflicts Managers' determinations concerning complaints or inquiries made by issuers or others should be timely communicated, in writing, to the inquirer or complainant, as well as to the company that is the subject of the proxy advisory firm report for which an inquiry or complaint was made.

**c. Engagement**

CCMC agrees with CSA's expectation that proxy advisory firms should disclose detailed policies regarding dialogues or contacts with issuers when they prepare vote recommendations.<sup>27</sup> Engagement with issuers is critical to the production of informed proxy voting reports and vote recommendations, and we recommend that CSA, at a minimum, adopt the approach to proxy advisory firm engagement proposed by France's AMF—specifically, that proxy advisory firms:

- Submit pre-publication draft reports to relevant companies for review at least 24 hours prior to finalizing those reports;
- Include companies' reasonable comments on the voting recommendations in its report;
- Correct any substantive errors in their reports and reported by the companies, and ensure that corrections are submitted to investors as quickly as possible;
- Publish on their websites their rules on communications with companies, particularly policies regarding submitting draft reports; and
- Send concerned companies their final reports as soon as possible, at the same time as reports are distributed to clients.<sup>28</sup>

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<sup>27</sup> Proposed Guidance, *supra* n. 2, Part 2.4, "Communications with clients, market participants, the media and the public."

<sup>28</sup> AMF Recommendation, *supra* n. 11.

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In order to provide clients, issuers, and the public with a full understanding of the outside influences that may have an impact on the contents of reports and vote recommendations, dialogues and contacts with shareholders, clients or others with whom proxy advisors (or their employees or agents) discuss the proposed content or disposition of a prospective vote recommendation must be disclosed. Disclosures should be uniform, detailed, prominently displayed, and subject to the review and approval of the proxy advisory firms' Conflicts Managers.

**d. Delegated Voting Authority**

As CSA's Proposed Guidance observes,<sup>29</sup> proxy advisory firms may provide automatic voting services to clients, based on the clients' proxy voting guidelines. In the U.S., this practice is rooted in two no-action letters issued by the SEC Staff—not the SEC itself—in 2004, which effectively amended Rule 206(4)-6 of the Investment Advisers Act, relating to portfolio managers' responsibility to vote the securities in their portfolios in the best interests of the investors whose money they manage.<sup>30</sup> One year after the Rule's adoption, the SEC's Staff effectively amended Rule 206(4)-6, and embraced a one-size-fits-all approach, by issuing no-action letters to two proxy advisory firms, Egan-Jones and ISS.<sup>31</sup> These Letters, issued by the SEC Staff without Commission review, effectively enabled portfolio managers to ameliorate their own conflicts by outsourcing voting decisions to proxy advisory firms, irrespective of whether or not the proxy advisory firm has its *own* conflict with respect to any company or issue.

Thus, in the Egan-Jones Letter, the Commission's Staff opined that conflicted portfolio managers could avoid the consequences of their own conflicts by delegating voting authority to a proxy advisory firm that is independent of the portfolio manager.

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<sup>29</sup> Proposed Guidance, *supra* n. 2, at p. 4343.

<sup>30</sup> SEC Investment Advisers Act Rule 206(4)-6, 17 C.F.R. §275.206(4)-6 (2014), available at <http://www.ecfr.gov/cgi-bin/retrieveECFR?gp=&SID=fcb0046d2c225b4e99b3caf364eb8469&r=PART&n=17y4.0.1.1.21#17:4.0.1.1.21.0.142.3>. The Rule affirmed the existing obligation of institutional portfolio managers to apply fiduciary standards in voting proxies with respect to portfolio securities.

<sup>31</sup> See Egan-Jones Proxy Services, SEC Staff No-Action Letter (May 27, 2004) ("Egan-Jones Letter"), available at <http://www.sec.gov/divisions/investment/noaction/egan052704.htm>; see Inst'l Sh. Services, Inc., SEC Staff No-Action Letter (Sep. 15, 2004) ("2004 ISS Letter"), available at <http://www.sec.gov/divisions/investment/noaction/iss091504.htm>.

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Giving legitimacy to a proxy advisory firm's conflicts, the Staff embraced, as a general rule, that "the mere fact that the proxy voting firm provides advice on corporate governance issues and receives compensation from the Issuer [that is the subject of a proxy advisory firm's recommendations] for these services generally would not affect the [proxy voting] firm's independence *from an investment adviser*."<sup>32</sup> Subsequent to the Egan-Jones Letter, ISS sought and received Staff assurances that "a case-by-case evaluation [by institutional portfolio managers] of a proxy advisory firm's potential conflicts" is *not* necessary; instead, portfolio managers could *assume* a proxy advisory firm's lack of specific conflicts solely "based on the firm's general conflict *procedures*."<sup>33</sup>

These no-action letters enable proxy advisory firms to avoid case-by-case scrutiny of their potential conflicts of interest, negating the Commission's imposition of effective standards for the disclosure and avoidance of conflicts by institutional portfolio managers. As a result, fund advisers are encouraged to utilize, rely upon and predicate voting decisions on advice they obtain from, proxy advisory firms that may be conflicted, and whose agendas may be inconsistent with fund managers' duty to vote portfolio shares to further the *economic* interests of their investors.<sup>34</sup>

The incidence of proxy advisory firms' provision of automatic vote services to clients based on the proxy advisory firm's proxy voting guidelines is a direct consequence of these no-action letters. CCMC believes that these no-action letters, and the automated voting they have spawned, have had a deleterious effect on corporate governance. Given CSA's recognition that proxy advisory firms' policy guidelines and vote recommendations impact investors, issuers and the public, and the collective nature of proxy voting results in each shareholder's vote having an impact on every other shareholder, investors, issuers and the public must be able to access, by company and voting item, the number and percentage of shares that are voted automatically in accordance with proxy advisory firms' guidelines.

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<sup>32</sup> See Egan-Jones Letter, *supra* n. 31 (emphasis supplied).

<sup>33</sup> See 2004 ISS Letter, *supra* n. 31 (emphasis supplied).

<sup>34</sup> See OIG Department of Labor Report, *Proxy-Voting May Not Be Solely for the Economic Benefit of Retirement Plans*, Rpt. No. 09-11-001-12-121, (Mar. 31, 2011), available at <http://www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121.pdf>.

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June 20, 2014  
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### Conclusion

CCMC again thanks CSA for its initiative reflected in the Proposed Guidance. It is an important step toward bringing transparency and accountability to the proxy advisory industry, without the necessity of imposing further regulations. CCMC's suggestions, each already formulated in other contexts, can readily be adapted to CSA's already impressive and thorough Proposed Guidance. Doing so would enable CSA to avoid some of the pitfalls that have already been experienced by other voluntary codes of conduct for proxy advisory firms. We would be happy to discuss any issues with appropriate CSA Staff.

Sincerely,

A handwritten signature in black ink, appearing to read 'TK' followed by a long horizontal flourish.

Tom Quadman