

Corporate Securities Law

June 25, 2012

Canadian Securities Administrators Considering Regulation of Proxy Advisory Firms

The role of proxy advisory firms in the marketplace has grown dramatically and has been the subject of considerable and increasing discussion and comment. On June 21, 2012, the Canadian Securities Administrators (the “CSA”) joined the debate, issuing a detailed consultation paper outlining the functions served by proxy advisors, the concerns raised by capital markets participants and possible regulatory responses. The CSA’s accompanying request for comment invites feedback on both the need for regulatory oversight as well as the form such regulation might take.

Proxy Advisors’ Role and Increasing Prominence

Proxy advisory firms make voting recommendations on matters put to public companies’ shareholders for voting. The matters for which proxy advisory firms may make a vote recommendation range from routine governance matters to complex M&A transactions. While those recommendations are prepared for clients (generally institutional investors) of the proxy advisory firms, the recommendations generally become broadly disclosed and inform strategies and voting decisions by a wider universe of market participants.

The importance of proxy advisors has expanded as the range of issues put to a shareholder vote, and the complexity and detail of the related disclosures, have increased. Institutional shareholders (which according to the consultation paper hold approximately 32% of shares of TSX-listed issuers) rely on proxy advisors in various ways – some automatically follow the proxy advisors’ recommendations, and others consider them a supplement to their own analyses and/or as an element of their discharge of fiduciary obligations. Publication

of proxy advisors’ recommendations may also influence non-client investors, such as retail holders. The perceived influence of vote recommendations has risen to the point where some suggest the success or failure of an issuer’s proposal depends on the voting recommendation of a proxy advisor.

Potential Concerns and Possible Regulatory Responses

While acknowledging that proxy advisory firms serve a legitimate purpose, and that their influence may enhance ‘corporate governance best practices’, the CSA outlined several potential concerns that have been raised by their expanding role, noting that proxy advisors are not presently subject to regulation in Canada. Those concerns, and the CSA’s proposed regulatory responses, are as follows:

Conflict of Interest – The CSA noted that conflicts of interest can arise where a proxy advisory firm advises both shareholders and public companies. The conflict is most evident where a firm makes voting recommendations to shareholders concerning matters on which the firm has advised the issuer. The CSA acknowledges that proxy advisory firms generally have conflicts of interest policies and procedures in place, and dismisses the idea of prohibiting conflicts entirely. Instead, the CSA requests feedback on four possible regulatory responses, specifically that firms be required to (i) separate proxy voting services from the advisory or consulting services (similar to the separation of financial advisory services from traders and research analysts at an investment dealer), (ii) enact policies to identify and manage conflicts arising from vote recommendations, employee conflicts and ownership conflicts, (iii) disclose such procedures and actual conflicts, and (iv) regularly review conflict policies.

Lack of Transparency – A concern may exist with the absence of information about how proxy advisors arrived at their recommendation, in that investors may be unable to assess the quality of the data and analysis that inform the recommendation, and issuers may be unable to effectively respond. Acknowledging that it may not be appropriate to require the disclosure of an advisory firm’s report, for which clients pay a subscription fee, the CSA is seeking feedback concerning a requirement for disclosure of the analysis behind a

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vote recommendation, including the internal procedures, guidelines, standards, methodologies, assumptions and sources of information employed by the proxy advisor.

Inaccuracies and Limited Opportunity for Issuer Engagement –

The consultation paper notes that public issuers have also raised concerns about factual inaccuracies in proxy advisor reports and about the limited opportunity they have to engage with proxy advisors concerning those reports. The CSA's proposed regulatory response is to require proxy advisory firms to develop a policy that addresses an issuer's comments on a vote recommendation and the underlying analysis.

Corporate Governance "Standard Setters" – Concern has been expressed that, because of their influence, proxy advisory firms have ceased to be commentators and may have in fact become standard setters on governance matters. The consultation paper requests comments on a proposal to require firms to implement fair and transparent procedures for developing corporate governance standards, and public disclosure of such procedures and standards.

Next Steps

In the consultation paper, the CSA reviews existing regulatory frameworks and concludes that, if it is determined that there is a need for regulation of proxy advisory firms, the preferred approach would be to establish a new regulatory instrument rather than fit the new regulations into an existing framework.

Comment is sought on the need for regulation, on the issues and suggested responses, and on the extent of institutional investors' reliance on the advice of proxy advisors generally to assist in the analysis.

The paper includes specific questions for issuers and institutional investors designed to better inform the CSA before any further action is taken. The comment period for the paper is 60 days, ending August 21, 2012.

Please contact any member of Goodmans' Corporate Securities Group to discuss the consultation paper and the proposed regulation of proxy advisory services.