OSC Investor Advisory Panel
c/o Anita I. Anand
Associate Professor
Faculty of Law
University of Toronto
78 Queen's Park, Suite 301
Toronto, ON M5S 2C5
Email: iap@osc.gov.on.ca

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John Stevenson, Secretary
Ontario Securities Commission
20 Queen Street West, Box 1903
Toronto, ON M5H 3S8

Dear Mr. Stevenson,

Re: OSC Staff Notice 54-701

As members of the Commission's Investor Advisory Panel (IAP), this letter constitutes our submission regarding Staff Notice 54-701 "Regulatory Developments Regarding Shareholder Democracy Issues." [1] The IAP is an independent body that was appointed by the Ontario Securities Commission in August, 2010. We are charged with representing the views of investors and providing input on the Commission's policy initiatives, including proposed rules and policies, the annual Statement of Priorities, concept papers and other issues.

It seems trite to say that effective law is required to uphold a fundamental purpose of capital markets regulation: to ensure that all shareholders are adequately protected. In our view, such law ideally would ensure that shareholders, as investors in publicly-held corporations, have the ability to participate effectively in corporate decision-making. We proceed from this basic position, recognizing that there can be legitimate debate about what constitutes effective participation.

One issue that is likely not contentious is the notion that shareholder democracy is important to all investors, both institutional and retail. Indeed, we believe that the interests of retail and institutional investors are largely aligned on issues relating to shareholder democracy and corporate governance. We also wish to emphasize that a central principle of the IAP is that investors should be as well-protected in Ontario as they are in other developed market systems. The advances in shareholder democracy and corporate governance rules in other advanced markets highlight the need to examine the rights of investors in Canadian public corporations.

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[1] We are grateful to Corinne Bordman and Christopher Somerville, students at Bennett Jones LLP, for their excellent research assistance with regards to this submission.

Finally, it is important to recognize that there is some overlap between business corporations statutes and securities regulation on key issues relating to shareholder democracy, such as the proxy process including proxy solicitation. Such overlap can be confusing to investors, especially where the rules in each regime differ. It also leads to various inefficiencies such as the need to ensure compliance with the rules contained in two statutory regimes which are similar but may not be identical. We urge the Commission to coordinate with other bodies to reduce and if possible eradicate such overlap.

Majority Non-slate Voting

Staff Notice 54-701 provides an update from Commission staff on the current status of their work in the area of shareholder democracy issues and identifies the following issues as requiring additional review at this time and, potentially, the development of regulatory proposals for reporting issuers: slate voting and majority voting for uncontested director elections; shareholder advisory votes on executive compensation; and the effectiveness of the proxy voting system.

The Investor Advisory Panel endorses a legally-mandated requirement for all corporations to implement a system of majority voting in the election of individual directors. Without majority voting, shareholders' votes lack meaning. Under the current system of plurality voting, if a majority of shareholders vote against the slate or a particular candidate, those votes do not count as votes against the candidate. Instead, the votes are simply withheld and in effect serve as abstentions. This system can result in the successful election of candidates to whom a majority of shareholders is opposed but a minority (or, in an extreme example, even one) vote in favour. The purpose of the vote, which is to allow shareholders to participate in corporate decision-making, is undermined.

In terms of slate voting, presenting shareholders with a slate rather than allowing them to vote in favour of or against individual candidates also seems to lack a persuasive rationale. We believe that shareholders should be able to evaluate each candidate for director on his or her merit. Slates of directors, especially when utilized with plurality voting, allow management to set and implement its own directorial team, without effective input from shareholders.

The ability to elect or to remove individual board members can best be ensured through majority voting for individual directors. We do not believe that enforcing majority non-slate voting oversteps regulatory limits or restricts the ability of the board to function effectively. It ensures a fair and balanced process in the election of directors but does not impinge on the substantive decisions that boards make. It seems incomprehensible to us that a majority voting system has not already been adopted and implemented by securities regulators and their counterparts who lead legislative amendments with regards to business corporations statutes. We see no benefits to shareholders in the plurality voting system.

Some argue that moving to majority voting for individual directors runs the risk of leaving the corporation without directors, or without the ability to achieve balance among the board by having directors who bear specific skills.[2] We consider such eventualities to be highly unlikely, and if they do occur, are circumstances that can be addressed through other processes, including an additional shareholder vote. If a corporation is unable to convince a majority of its shareholders of the merits of a particular candidate or group of candidates, those candidates should be replaced by others who can command such a majority.

We note that the voluntary majority voting policy recommended by the Canadian Coalition for Good Governance (CCGG) to its members appears to have been quite successful in leading to a result that is similar to a rule relating to majority voting. Under this policy, a director who fails to win a majority of votes must resign his or her seat on the board – although the board still has discretion whether to accept that resignation.[3] 131 corporations representing 57 percent of the S&P/TSX composite have implemented this policy.[4] It appears that these corporations recognize the importance of ensuring that shareholders' votes are meaningful.

The Investor Advisory Panel does not believe that regulators can or should rely on purely voluntary methods in this instance. The voluntary policy recommended by the CCGG does not *ensure* that investors' votes against will be effective. The board may not accept the director's resignation, for example. Legal rules are required to ensure that all shareholders obtain the benefits of majority voting, including the ability to participate meaningfully in certain decisions of the corporation.

We do not agree that TSX Venture listed companies comprised primarily of small to medium size firms should be exempt from reforms to the current system of plurality and slate voting.[5] The traditional rationale for creating proportionate representation for these firms is that regulators must be sensitive to the burdens of regulation and paperwork on these smaller companies. However, reforms to the process by which directors are elected are not an administrative or regulatory burden in the way that increasing governance or disclosure obligations may be. Apart from the costs in transferring to a new system, the majority voting process should not impose undue costs on small to medium size issuers. Furthermore, to the extent that it does impose such costs, the benefits of ensuring majority non-slate voting to shareholders in our view outweigh the associated costs.

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[2] Institute of Corporate Directors (ICD), submission to OSC re Staff Notice 54-701 (March 28, 2011), at 3, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110328_54-701_magidsons.pdf>.

[3] Canadian Coalition for Good Governance (CCGG), "Majority Voting Policy" (March 2011), at 4, online: <http://www.ccgg.ca/site/ccgg/assets/pdf/Majority_Voting_March_10_2011.pdf>.

[4] CCGG, submission to OSC re Staff Notice 54-701, (March 31, 2011) at 3, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_denisond.pdf>.

[5] See *ibid.* Indeed, the CCGG points out that the number of corporations following its majority voting policy has plateaued and does not include many smaller corporations.

While the Investor Advisory Panel favours majority non-slate voting, we are concerned that in controlled corporations, majority voting is of little assistance in furthering the interests of minority shareholders. The remedial options available in the corporate statutes are of limited use; they are available *ex post* and can be costly. We encourage the Commission to examine the rights of shareholders in corporations with a controlling shareholder. We believe that a principle of shareholder democracy must take into account the interests of both majority and minority shareholders.

Relatedly, we are concerned about the rights of minority shareholders in corporations with dual or multiple voting class structures. The recent Magna transaction highlights the ability of controlling shareholders to extract exorbitant premia in sale of control transactions involving dual class share structures. We recommend that the Commission embark on a study regarding the means by which shareholders in corporations with multiple voting classes are and should be protected. The Commission's "public interest" power is not sufficient to protect minority shareholders in these corporations as it is a power that is aimed at protecting the capital markets generally not minority shareholders specifically.[6]

In light of the foregoing, we encourage the Commission to review the practice of plurality voting where directors are elected by slate. We also encourage the Commission to undertake more research regarding the information shareholders require to cast informed votes. Do current disclosure requirements, including the format of disclosure where plain language does not exist, permit informed voting? A similar question arises below with regards to executive compensation.

Say-on-Pay

The Investor Advisory Panel believes that advisory "say-on-pay" votes will likely lead to better and more fruitful exchanges between a corporation's senior management and board on the one hand and its shareholders on the other. An advisory vote allows shareholders to register disapproval of Board compensation policies without having to oppose outright the election of the entire Board or of members of the Board's compensation committee. In addition, such votes are likely to lead to heightened accountability for boards of directors.

Institutional investors in Canada and the U.S. have focused on corporate governance and executive compensation practices since the late 1980s when disclosure of executive compensation in the proxy circular began to be required.[7] Among other issues, these investors have concentrated on abuses of stock options, excessive levels of compensation, the lack of a connection between executive pay and company performance, and outsized benefits for short-term performance. The U.S.-based Institutional Shareholder Services

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[6] For a related argument, see Anita I. Anand, "Was Magna in the Public Interest?" (Draft paper dated March 3, 2011 on file with the author).

[7] Institutional Shareholder Services (ISS), submission to OSC re Staff Notice 54-701 (March 31, 2011) at 3, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_sistid.pdf>.

explains that, "[b]oards of directors and compensation committees in particular have been accused of being complacent, unqualified and beholden to management as directors shared in many lucrative compensation schemes along with company executives."[8]

A number of Canadian corporations argue that the Canadian context is substantially different from other advanced markets, including the U.S. The 2008 global financial meltdown led to widespread public disapproval of government bailouts of financial institutions and politicization of the issue of executive compensation. Some assert that Canada has no need to follow the lead of the U.S., the U.K., the European Union, or Australia in mandating advisory "say-on-pay" votes.[9] In support of this position, the Institute of Corporate Directors explains that, "[j]urisdictions which have introduced say-on-pay have generally done so as a political response by legislators to a mix of corporate scandals and public outrage at excessive or unjustified pay…While Canada has not been free from pay scandals, the instances of public outrage at executive compensation levels have been few. There is a reason for this. Canadian compensation levels have historically been significantly lower than in the U.S. or U.K."[10]

The lack of public outrage in Canada may stem from a "high boiling point" rather than shareholders' concerns with the deficiencies, perceived or otherwise, of executive compensation in Canadian corporations. Many institutional investors have endorsed the principle of an advisory vote on "say-on-pay" as an effective way to heighten accountability of the board regarding compensation and to increase communication between management and shareholders on this topic.[11] We envision a shareholder vote on say-on-pay that is specifically advisory; that is, a mechanism by which shareholders can register their views relating to a corporation's compensation policies. To make such a vote binding would exceed this purpose and interfere in the decision-making of the board of directors, who are, to be clear, bound by a statutory duty to act in the best interests of the corporation.

In supporting a shareholder vote relating to say-on-pay, we note that some investor groups support an exemption for smaller companies. For example, the investor group SHARE, a long-time pioneer of say-on-pay in Canada, called for exempting smaller TSX Venture companies from the advisory say-on-pay requirements.[12] We respectfully disagree. Smaller corporations are certainly at great risk of abuse and as much in need of

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8 *Ibid.*

9 See for example Magna International Inc., submission to OSC re Staff Notice 54-701 (March 31, 2011) at 2-3, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_shakeelb.pdf>.

10 ICD submission, *supra* note 1 at 4.

11 See OMERS, *Proxy Voting Guidelines*, at 21-22, online: <http://www.omers.com/pdf/Proxy_Voting_Policy.pdf>; CPP Investment Board, *Proxy Voting Principles and Guidelines* (February 9, 2011), at 10, online: < http://www.cppib.ca/files/PDF/Proxy_Voting_Guidelines_Feb2011.pdf >; CalPERS, "CalPERS Endorses Investors' Appeal for Shareholder 'Say on Pay'" (January 28, 2010), online: <http://www.calpersresponds.com/issues.php/Calpers-Endorses-Investors-Appeal-for-Shareowner>.

12 Shareholder Association for Research & Education (SHARE), submission to OSC re Staff Notice 54-701 (March 31, 2011) at 4, online: <http://www.osc.gov.on.ca/documents/en/Securities-Category5-Comments/com_20110331_54-701_oneilll.pdf>.

an advisory vote if not more. The securities of these corporations are frequently held by a controlling shareholder that may or may not be an insider. Shareholders of small to mid-size corporations would certainly benefit from an advisory vote.

We note that other jurisdictions are taking more radical steps than the reform we support here. For example, votes on executive compensation in the Netherlands are binding, not advisory. The Investor Advisory Panel does not support a binding say-on-pay vote, which would serve to shift ultimate responsibility from the board of directors to shareholders. Interestingly, an Australian law that is currently before Parliament in that country would compel corporations whose executive compensation policies have attracted greater than 25 percent negative votes in two consecutive years to conduct a new election for their boards. While this is a policy that could be considered for Canada down the road, we do not believe that it is necessary at this time.

The approach that we favour is one that balances the ability of shareholders to express their approval (or disapproval) with a corporation's compensation policies on the one hand and management and the board's ability to set these policies on the other. We believe that given new insights on financial literacy, and the complexity of executive compensation packages, a crucial issue is the information that retail investors require to evaluate executive compensation. Shareholders' ability to participate in managerial decision-making is bound up with the information that is provided to them. Such information should be clear, concise and easy to understand.

Proxy Process

The mechanics of shareholder voting are complex. Few who are not direct practitioners in the field can grasp the fundamentals, let alone the numerous occasions where things can and do go wrong. It is beyond the scope of the Investor Advisory Panel's submission to delve deeply into the inner workings of "proxy plumbing." Yet ensuring that all valid shareholder votes are counted, i.e. that the plumbing actually works, is fundamental to shareholder democracy. We endorse the call by Davies in its October 2010 "The Quality of the Shareholder Vote in Canada" for a task force to examine all aspects of shareholder voting in Canada.[13] We share their belief in core principles for such a voting system: it must be transparent, comprehensive, with equality of weight per vote, encouraging voting by those with an economic interest.

We also echo the views of others, including the U.S. Council of Institutional Investors, that the principles underlying reform in this area should focus on the following objectives:

- **Timeliness.** Voting related communications should reach eligible voters in sufficient time to allow for careful review of the materials and to facilitate voter participation.

[13] Davies Ward Phillips & Vineberg LLP, "Discussion Paper: The Quality of Shareholder Vote in Canada" (October 22, 2010) at 175, online: <http://www.dwpv.com/shareholdervoting/>.

- **Accessibility.** Technology could improve the proxy voting process. However, mechanisms must ensure that shareholders receive proxy materials and can vote even if they lack electronic voting and communications methods.

- **Accuracy.** All votes properly cast should be correctly tallied.

- **Certainty.** End-to-end confirmation should enable both companies and shareowners to determine that votes properly cast were included in the final tally.

- **Cost-effectiveness.** The costs of transmitting proxy material and votes should be reasonable.[14]

Our overall concern is to ensure transparency for investors in the voting process. When an individual purchases securities in a corporation, he or she should be able to understand the mechanisms by which voting will occur. The current system does not allow for such transparency.

Retail Investor Participation

We recognize like others that retail investors often do not have the experience, knowledge, time or inclination to read disclosure and to understand their rights as contained in the corporate statutes and securities legislation. They may not know details about a particular director and his or her qualifications. They may not have an informed view on what is fair executive compensation or, more generally, what rights they have in a particular instance. As part of a broader study of the details of proxy voting, the Investor Advisory Panel also calls for an investigation of methods that could improve the quality and extent of retail voting. If the Commission is to take the principles of shareholder democracy seriously, it should consider means by which it can educate and encourage shareholders to express their opinions and intervene more actively in the governance of their investments including compelling corporations to produce information that is clear, concise and accurate.

Interesting data on this point has emerged in the United States, where many retail investors are not exercising their rights or voting in shareholder elections. In 2010, only 13.9 percent of U.S. retail investors voted their shares, compared to 19.4 percent of all investors.[15] U.S. retail investors own 25 percent to 30 percent of equities through direct purchases and 70 percent to 75 percent through ownership in mutual funds, pension funds and other intermediaries.[16] Although we do not have comparable statistics in Canada, anecdotal evidence indicates that retail participation rates here are also proportionately

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[14] Council of Institutional Investors, *Statement of Principles for an Effective and Efficient Proxy Voting System* (adopted April 13, 2010), as cited in CCGG submission to OSC, *supra* note 3 at 8-9.

[15] Broadridge, *Notice and Access: 2010 Statistical Overview of Use with Beneficial Shareholders* (as of June 30, 2010) at 4, online <http://www.broadridge.com/notice-and-access/FY10_full_year.pdf >.

[16] VoterMedia.org submission to the Securities and Exchange Commission (SEC) re SEC Concept Release on the U.S. Proxy System (September 29, 2010) at 1, online: <http://www.sec.gov/comments/s7-14-10/s71410-52.pdf>.

low, if not lower. Other advanced markets have concluded that the meager retail investor participation rates pose a problem to shareholder democracy. The U.K.[17] and the European Union[18] have thus issued reports and changed some of their laws and regulations.

An entire section of the U.S. Securities and Exchange Commission's Concept Release on Proxy Voting of October, 2010 is devoted to this issue.[19] Among others, the SEC suggested education campaigns for retail investors through plain-language websites and speaking engagements; advance voting instructions which could lead to more discussion between investors and their brokers about proxy issues; facilitating more investor-to-investor communications; and using the Internet, data tracking and other technology tools to facilitate electronic dissemination and tracking of votes. Various U.S. investor rights groups have also advocated specific methods to boost retail participation.[20]

We recognize that encouraging retail participation falls outside what is traditionally understood as "investor protection". However, we believe that the Commission should consider the practical realities relating to the absence of retail participation in public corporations. In light of these realities, we encourage the Commission to examine and implement steps to motivate shareholders to exercise the rights that are legally provided to them.

We thank you for considering our comments on Notice 54-701.

Yours very truly,

Anita Anand

Chair, Investor Advisory Panel and all of the members of the Panel, including: Nancy Averill, Paul Bates, Stan Buell, Lincoln Caylor, Steve Garmaise and Michael Wissel

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17 Report by Paul Myners to the Shareholder Voting Working Group, *Review of the impediments to voting UK shares* (January 2004), online: <http://www.manifest.co.uk/myners/04-02-04%20Final%20SVWG%20Report.pdf>.

18 Directive 2007/36/EC of the European Parliament and of the Council "Directive on the exercise of certain rights by shareholders in listed companies" (July 11, 2007), online: <http://eur-lex.europa.eu/Notice.do?hwords=&pgs=10&list=452297:cs,&val=452297:cs&nbl=1&lang=en&pos=1&page=1>.

19 See pages 78-96, online: <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

20 These include the following:

1) VoterMedia.org advocates open (available on the Internet) and free (without cost to the shareholder) client directed voting to improve both the quality and quantity of retail voting, *supra* note 15 at 2.

2) The CFA Institute, the trade association for Chartered Financial Analysts, endorsed a number of steps to increase retail participation including data tagging and the use of broker web sites for voting instructions; CFA Institute, submission to the SEC re Concept Release on the U.S. Proxy System (November 22, 2010) at 4, online: <http://www.sec.gov/comments/s7-14-10/s71410-275.pdf>.

3) Shareowners.org, a grassroots organization of individual shareowners, recommended the use of technology such as automated voting platforms and a per-ballot fee paid by the issuer to allow retail access to proxy advisory services; Shareowners.org, submission to the SEC re Concept Release on the U.S. Proxy System (October 20, 2010) at 1, online: <http://www.sec.gov/comments/s7-14-10/s71410-193.pdf >.

cc. Allan Krystie