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Dear Me Beaudoin,

Proposed National Policy 25-201 Guidance for Proxy Advisory Firms

Thank you for providing us with the opportunity to comment on the proposed National Policy 25-201 *Guidance for Proxy Advisory Firms* (Guidance).

The Australian Institute of Company Directors (Company Directors) is one of the two largest member-based director association worldwide with over 35,000 members, including individual members from a wide range of corporations: publicly-listed companies, private companies, not-for-profit organisations, charities, and government and semi-government bodies. As the principal professional body in Australia representing a diverse membership of directors, we offer world class education services and provide a broad-based director perspective to current director issues in the policy debate.

While we are based in Australia, we believe that it is important to comment on the proposals set out in the Consultation Document as there is a tendency for Australian regulators to look to the regulations that are in place in other jurisdictions when developing regulation for Australia.

We are also a member of the Global Network of Director Institutes (GNDI), of which we are currently the Secretariat. GNDI brings together member-based director associations from around the world with the aim of furthering good corporate governance. It is the international network for leading membership organisations of directors in Australia, Brazil, Canada, Europe, Hong Kong, Malaysia, Mauritius, New Zealand, South Africa, Thailand, the United Kingdom, and the United States. This submission has been informed in part by members of GNDI, including the Institute of Corporate Directors in Canada.

We have attached a copy of the global perspective paper of the GNDI in relation to **Board-Shareholder Communications** and hope that this will be of assistance when considering submissions on the draft Guidance.

You may also find it useful to refer to an independent research report that Company Directors commissioned in 2011, **Institutional share voting and engagement**[1], which explores the effectiveness of the engagement between directors, institutional shareholders and proxy advisers and provides a map of the institutional share voting process in Australia. While the report was limited to looking at companies in Australia, we expect that many of the findings of the report will be relevant to the issues that the Canadian Securities Administrators (CSA) is seeking views on.

Additionally, while we do not intend to comment specifically on all of the issues raised by the Notice and Request for Comment, Company Directors would like to take this opportunity to make some general comments relating to some of these issues.

General comments

In our view, it is important for proxy advisors to be governed by a set of "good practice" principles and guidance. The exercise of voting rights by shareholders is a critical component of corporate governance and proxy advisory firms play an important role in this. In order for shareholders to make informed voting decisions, the information that they are provided with must be accurate and not misleading, whether the information is provided by the issuer, its directors or from some other intermediary, such as proxy advisory firms.

Despite proxy advisory firms playing such an important role and, in our view, exerting significant influence over their clients with respect to the exercise of voting rights, they are currently not held to any standard with respect to the communications that they make to shareholders. Some but not all proxy advisory firms may be registered as investment advisors, however the full scope of their work extends well beyond those specific advisory areas that are regulated. This relatively light regulatory burden is to be compared with the obligations of issuers and their directors who, in most jurisdictions, must comply with a number of regulations with respect to shareholder communications, and have potential liability in the event the materials that they send to shareholders contain inaccuracies, misrepresentations and/ or misleading statements.

There is clearly a disconnect between the influence and the accountability of proxy advisory firms. We believe that this disconnect undermines the exercise of voting rights by shareholders and impacts on the integrity of capital markets. In our view, this disconnect needs to be addressed. While the draft Guidance represents a useful step towards this, there are still a number of areas of concern that have not, in our view, been adequately addressed. These are set out in more detail below.

Voluntary approach – the need for accountability

We do not agree that the Guidance should apply to the proxy advisory industry on an entirely voluntary basis. Unlike corporate governance principles, where retaining a certain amount of flexibility is necessary, a code of practices that is intended to govern the professional conduct of an industry and hold participants accountable does not require similar flexibility, as complying with such practices should not involve matters of judgement.

Currently, proxy advisory firms are relatively unregulated, even though, as noted above, one of their key activities (ie shareholder communications) is subject to a number of regulations when undertaken by an issuer or its directors or, to a lesser extent, by a

[1] A copy of this research report can be located at: http://www.companydirectors.com.au/~/media/Resources/Director%20Resource%20Centre/Research/AICD%20%20ISVotingWeb_FINAL.ashx

broker or analyst. While we do not necessarily think legislative intervention is required at this stage, we do think that proxy advisory firms should, at a minimum, be required to meet the standards set by the Guidance. Our view is that the proxy advisory industry should be regulated by an industry body that could set and enforce professional standards, investigate complaints and administer discipline to ensure the integrity of the services being provided by proxy advisory firms.

Conflicts of interest

Having an appropriate conflicts of interest policy in place to manage potential and actual conflicts is essential to ensure the integrity of the advice that proxy advisory firms provide to their clients. It is also essential that proxy advisory firms publicly and comprehensively disclose all conflicts on any matter in respect of which they are issuing a voting recommendation. Proxy advisory firms should also set up "Chinese walls" and adopt other structural solutions to further reduce the likelihood of bias in the advice that they provide.

Currently, 2.1 of the Guidance does not go far enough to ensure that conflicts of interest will be appropriately dealt with. Where the management and disclosure of a potential or actual conflict will not be sufficient to ensure the integrity of the advice given, proxy advisory firms should be required to refrain from providing the particular service. One such circumstance will be where a proxy advisory firm is asked by a client to make recommendations with respect to an issuer that it has provided consulting services to.

To address these issues and to strengthen the proposed conflicts of interest requirements under 2.1 of the Guidance, at a minimum we believe that 2.1 should be expanded to include requirements that:

- proxy advisors avoid conflicts of interest with their clients. The proxy advisor should adequately disclose any conflict and the steps which it has taken to mitigate the conflict in order that the client can make a properly informed assessment of the proxy advisor's advice;
- where a conflict actually or potentially arises with respect to a voting recommendation that the proxy advisory firm will be issuing, the conflict be publicly and comprehensively disclosed;
- "Chinese walls" and other appropriate structural solutions be adopted and set up to further reduce the risk of bias in the advice provided by the proxy advisory firms; and
- voting recommendations not be issued on matters where the proxy advisory firm has provided consulting services to the issuer or, if applicable, where the proxy advisory firm's owner or significant investor has a material interest.

While the above amendments are required to strengthen the Guidance, there is one area where we believe the Guidance does in fact go too far. In particular, the expectation under 2.2(4) of the Guidance that the board of directors of a proxy advisor preserve the culture of compliance respecting conflicts of interest and also ensure that individuals acting on behalf of the proxy advisory firm are made aware of its policies and procedures and code of conduct. These expectations are, in our view, inappropriate, unreasonable and not practicably achievable by the board of directors. It places too high a burden on the board (particularly non-executive directors who are not part of management) and blurs the roles and responsibilities of the board with those of senior management.

As overseers of compliance, the board is not in a position to "preserve" or "ensure" the matters that it is expected to under the Guidance as they are either matters that are

outside their purview or they are matters that are not really capable of being determined with the requisite degree of certainty. The role of the board of a company is one of monitoring, oversight and strategy. Management, on the other hand, is responsible for the day-to-day operations of the company and for the implementation of strategy set by the board. The expectation for the board to "preserve" a culture of compliance and to "ensure" that individuals acting on the proxy advisory firm's behalf are made aware of its policies and procedures and code of conduct are unreasonable standards that would require boards to become intimately involved, akin to management, in the compliance systems of the company, rather than taking an oversight role, setting the compliance culture and satisfying itself that the compliance framework is sound. For this reason, 2.2(4) of the Guidance should be amended to remove these expectations from the board.

Transparency and accuracy of voting recommendations

Where proxy advisory firms provide clients with information that is intended to influence or assist in deciding how to exercise their voting entitlements, it is crucial that the information provided is meaningful, accurate and not misleading.

Company Directors and a number of the other GNDI member organisations are aware of circumstances in their relevant jurisdictions where the voting recommendations of proxy advisory firms have contained, or have been based on, mistakes and inaccuracies. This could be addressed by requiring that all voting recommendations be "fact checked" by the relevant issuer before the recommendation is finalised – especially where the recommendation is to vote against a resolution.

It is essential that proxy advisory staff be sufficiently experienced and have appropriate expertise and knowledge to understand the drivers of shareholder value creation in companies. Globally, directors and issuers have expressed their concerns about the quality and inexperience of proxy advisory staff who are required to analyse and opine on complex subject matter but who are unable to form a proper understanding of the issues. This is particularly an issue where the recommendations relate to remuneration resolutions (for example, to approve a remuneration policy or to approve a director or executive's remuneration arrangements) as understanding these matters often requires a high level of financial and legal expertise and/or experience. In our experience, the proxy advisory staff who are analysing these issues do not necessarily possess this.

We do not think that 2.3 of the Guidance goes far enough to address these concerns to provide assurance and accountability with respect to the quality of the services being provided by proxy advisory firms.

At a minimum, 2.3 should be expanded to include requirements that:

- before voting recommendations are finalised, that an opportunity be provided for them to be "fact checked" by the relevant issuer;
- proxy voting guidelines not be applied rigidly as a "one size fits all" by allowing flexibility to take into account local market and other regulatory conditions as well as the particular circumstances of the issuer where its corporate governance practices do not strictly conform with the guidelines;
- proxy advisory staff possess appropriate qualifications and experience to analyse or advise on the relevant issues. Details of the qualifications and experience of the staff should be disclosed, as well as the resources that the proxy advisory firm allocates to the analysis of meeting resolutions and outsourcing arrangements for the purposes of making voting recommendations; and

- sufficient time, resources and expertise must be allocated to analysing the issues necessary to make informed and accurate voting recommendations.

Communications with clients, market participants, the media and the public
We do not agree that it is appropriate for proxy advisory firms to be able to decide whether or not to engage with issuers.

Where a proxy advisory firm intends to issue a contrary voting recommendation, the firm should be required under the Guidance to share its report with the issuer and discuss its proposed contrary recommendation **before** the recommendation is finalised and published. In the event that the proxy advisory firm still intends to recommend a contrary voting recommendation after this engagement, the proxy advisory firm should be required to include the company's response to the firm's analysis and conclusions together with the proxy advisor's voting recommendation.

In our view, by requiring this engagement and disclosure, the likelihood of contrary recommendations being made that are based on inaccuracies or are misleading will be greatly reduced. It will also mean that proxy advisory firms will be able to present a more fully considered view in their final recommendations and, importantly, that their clients will be able to make more informed voting decisions based on these recommendations.

Accordingly, as a minimum, we believe that the 2.4 of the Guidance should be expanded to include requirements that:

- where a proxy advisory firm intends to issue a contrary voting recommendation with respect to an issuer, they must take active steps to engage with the issuer by sharing a copy of its draft report with the issuer and discussing the proposed contrary recommendation **before** the recommendation is finalised and published to voters; and
- if, following this engagement, the proxy advisory firm still intends to make a contrary recommendation, the issuer should be provided with sufficient time and opportunity to provide a response to the proxy advisory firm which must be included as part of the analysis in the materials that is provided to the proxy advisory firm's client.

If you would like to discuss any aspect of our views please contact our Senior Policy Advisor, Gemma Morgan on (02) 8248 6600.

Yours sincerely,

John H C Colvin
Chief Executive Officer &
Managing Director