HANSELL LLP

November 13, 2013

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

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

Hansell LLP provides expert, independent legal and governance counsel to both investors and boards of directors, which practice brings us into frequent contact with the proxy voting infrastructure. In addition, we have devoted considerable resources to a study of proxy related issues, having conducted interviews with transfer agents, proxy service providers, investment industry intermediaries, custodians and investors. As such, we appreciate the opportunity to provide comments on CSA Consultation Paper 54-401 *Review of the Proxy Voting Infrastructure* (the **CSA Consultation Paper**).

We commend the CSA for undertaking this review. We note that over recent decades, the role of shareholder voting has become progressively more important, as regulators and other parties have increasingly relied upon shareholder approval to address various governance issues, including those with respect to related party transactions,[1] director elections,[2] and executive

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1 See, for example, Multilateral Instrument 61-101 *Protection of Minority Security Holders in Special Transactions* available at < http://www.osc.gov.on.ca/en/13230.htm>

2 On October 4, 2012 the Toronto Stock Exchange published a notice of approval regarding amendments to its TSX Company Manual that require listed issuers to conduct individual director voting, annual director elections and to provide disclosure of all voting results and majority voting policies. See < http://tmx.complinet.com/en/display/display_main.html?rbid=2072&element_id=808>

compensation.[3] In addition, we note the recent CSA proposal that would allow a shareholder rights plan adopted by an issuer's board of directors to remain in place provided majority security holder approval of the rights plan is obtained within the specified time period.[4] However, in our view, all of these developments will be undermined if market participants have less than full confidence in the integrity of the proxy voting system. Recent evidence, including anecdotal evidence, suggests that the proxy voting system may not work perfectly.[5]

We believe that the CSA Consultation Paper identifies issues that are crucial for the development and maintenance of a reliable and efficient proxy voting infrastructure. We have provided the following comments to you in order to share our views of the issues.

A. Vote Reconciliation Issues

We agree with the assertion in the CSA Consultation Paper that a central function of the proxy voting infrastructure is to facilitate vote reconciliation. In our view, it is unacceptable to have a proxy voting infrastructure that cannot determine, with any confidence, the number of votes that are eligible to be voted on a corporate matter, and who has the right to exercise those votes. The failure to reconcile voting entitlement records can ultimately lead to a single voting entitlement being voted more than once (also known as **over-voting**) or to the inappropriate prorating or discarding of otherwise validly cast votes.

The CSA Consultation Paper identifies three issues, two of which (securities lending and restricted proxies) may contribute to the problem of over-voting and one (omnibus proxies) that may lead to validly cast votes being improperly discarded by the tabulator. We will provide comments on each of these issues in turn.

1. Securities Lending and Over-voting

The issue of over-voting has been much discussed in recent years, however it remains difficult for a third party observer to determine how often it may occur, and what impact it may have. The Investment Industry Association of Canada (or **IIAC**) has stated its belief that over-voting does not materially affect shareholder voting on a widespread basis and its members are able to

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3 The Canadian Coalition for Good Governance, an organization that represents 46 members who manage nearly $2 trillion in assets on behalf of Canadians, recommends that boards voluntarily add to each annual meeting agenda a shareholder advisory vote on the board's and company's reports on executive compensation contained in its annual proxy circular. See CCGG Policy *Model 'Say on Pay' Policy for Issuers* dated September 2010 available at <http://www.ccgg.ca/site/ccgg/assets/pdf/model_policy_on_say_on_pay.pdf>

4 See proposed National Instrument 62-105 *Security Holder Rights Plans* published for comment on March 14, 2013 at < http://www.osc.gov.on.ca/en/SecuritiesLaw_62-105.htm>.

5 For a summary of recent concerns with the proxy voting infrastructure, see *The Quality of the Shareholder Vote in Canada* dated October 22, 2010 by Carol Hansell, Mark Connelly, Michael Disney, Gillian Stacey, Tim Baron, Adam Fanaki and Richard Fridman available at <www.dwpv.com> [**Davies Paper**].

identify and correct potential over-reporting[6] situations before the voting deadline by using the Over-Reporting Prevention Service provided by Broadridge Investor Communication Solutions Canada (**Broadridge**). However, we note that Broadridge's service operates only to identify vote totals that are in excess of an intermediary's CDS position, and the evidence from retail investors suggests that they often do not vote their shares.[7] As a result, routine over-voting may be occurring without ever engaging the Over-Reporting Prevention Service. Moreover, we note that while Broadridge's service 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.

We are also aware of the voting discrepancies reported by Computershare Limited, which noted that unresolved over-voting occurs in at least 17% of shareholder meetings for which they act as transfer agent.[8] These findings are alarming and further suggest that over-voting is a systemic problem that would merit further study.

The possibility that over-reporting and over-voting will be detected and potentially reconciled increases when voter participation is high, such as in the case of a contentious meeting. If over-reporting is identified and cannot be reconciled prior to the meeting, the tabulator will determine how a proxy should be counted either by taking instructions from the issuer, the issuer's governing statute, articles or bylaws, or by applying the "presumptions" contained in the STAC Proxy Protocol.[9] We have been advised that some tabulators accept votes on a "first in" basis up to the aggregate amount indicated in CDS's records and refuse to accept any excess votes subsequently remitted. Another common last-minute solution to over-voting is to "pro-rate" the results by reducing the voting position of each shareholder. However, such solutions are not publicly communicated to shareholders, which contributes to a lack of integrity and transparency in the proxy voting infrastructure. Ultimately, while these solutions are practical, they remain unsatisfying from the point of view of shareholder democracy.

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6 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.

7 See SEC Concept Release, *infra* note 19 at 33. Although it refers to low levels of retail participation in the U.S. markets, we are not aware of any reason why retail participation levels in Canada would differ significantly.

8 Letter from Computershare to Robert Day in response to *OSC Statement of Priorities for Financial Year to End March 31, 2013* (May 28, 2012) available at <http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20120528_11-766_donaldsonl_makuchc.pdf>.

9 Securities Transfer Association of Canada, "Proxy Protocol" (March, 2012) available at <http://www.stac.ca/Public/PublicShowFile.aspx?fileID=199>.

(a) Does Over-Voting Matter?

Even if, as IIAC suggests, over-voting does not materially affect shareholder voting on a widespread basis, it remains clear that over-voting could materially affect the outcome of any one particular meeting. To illustrate this point, we note the following example. A company with 100 shares outstanding is held through two equal CDS accounts, with one of the proximate intermediaries (**Financial Institution A**) holding 60 shares through various custodians and client accounts, and the other intermediary (**Financial Institution B**) holding the remaining 40 shares.

Assume a hedge fund borrows 10 shares from Financial Institution A in order to short the company's securities and one of Financial Institutions B's clients takes the long position. In this case, the reconciled CDS record will show 50 shares for both Financial Institution A and Financial Institution B.[10]

If 80% of eligible votes are cast for any particular meeting, it becomes apparent how over-voting can bias voting results. Broadridge, on behalf of Financial Institution B, would distribute 50 voting instruction forms (**VIFs**) and would receive 40 (80%) completed VIFs back. However, if Financial Institution A does not pre-reconcile the 10 lent shares to any particular client account, it would distribute 60 VIFs and receive 48 (80%) completed VIFs back. Eight of the votes from Financial Institution A are over-votes resulting from the outstanding securities loan position. While, in this example, the over-vote is only eight votes, we note that this discrepancy could represent the difference between a resolution passing or failing.

(b) Securities Lending as a Contributor to Over-Voting

Securities lending describes the market practice whereby securities are temporarily transferred from one party (the lender) to another party (the borrower) in return for a fee. As part of the lending agreement, the borrower is obliged to redeliver to the lender securities that are identical to the securities transferred or lent, either on demand or at the end of the loan term. The supply of securities into the lending market comes mainly from the portfolios of beneficial owners, such as pension and mutual funds, insurance companies and endowments, or from securities held by broker-dealers in margin accounts.

Securities lending plays an important role in the efficiency of capital markets by providing liquidity that reduces the cost of trading and promotes price discovery in rising as well as falling markets. Securities lending also promotes confidence in the capital markets by allowing market participants to sell securities that they do not own knowing that they can be borrowed prior to settlement. The most common reason to borrow securities is to cover a short position using the borrowed securities to settle an outright sale.

Canada's securities lending market is well established and highly international in terms of participation and securities traded. Information about ongoing securities lending transactions

10 In this case, Financial Institution A would be "over-reporting" it position by 10 shares.

showing the size or composition of specific outstanding loan positions in the Canadian markets is not available. However, TSX Markets (a division of TSX Inc.) publishes delayed aggregate information on short positions. The *Top 20 Largest Consolidated Short Position Report Highlights*[11] is produced twice monthly, effective the 15th and the end of each month. TSX Markets collects this information on behalf of the Investment Industry Regulatory Organization of Canada (**IIROC**). TSX Participating Organizations are required to file this information pursuant to Universal Market Integrity Rule 10.10.[12]

IIROC also prepares and publishes the *Short Sale Trading Summary Report*[13] which shows the aggregate proportion of short selling in the total trading activity of a particular security, based on data for trades marked "short sale" supplied to IIROC by each marketplace monitored by IIROC. The report is produced twice monthly, for the period from the first to the 15th of each month and for the 16th to the end of each month. The report shows the number, value and volume of short sales of each listed security and also as a percentage of total trading activity for the security, based on the total aggregate trading on all marketplaces during the reporting period.

The reports above suggest that securities lending is prevalent in Canada, and therefore could have a potential impact on the accuracy of the voting process.

(i) Impact of securities lending on generating the voter lists

Securities lending programs are typically managed by intermediaries acting on behalf of both retail and institutional investors.

In the case of retail investors, broker-dealers engage in securities lending using the shares held in their clients' margin accounts. In a standard margin account agreement between a broker-dealer and its client, the client agrees that securities held in the margin account may be subject to lending programs at any time when the account shows indebtedness. The standard margin account agreement further provides that, in connection with any securities loan, the client acknowledges that the broker-dealer lending the securities from the client's account may receive certain benefits to which the client is not entitled and that, under certain circumstances, the loans may limit the ability of the client to vote its securities. The following extract is taken from the account agreement of CIBC Investor Service Inc.

11 Toronto Stock Exchange, Top 20 Largest – Consolidated Short Position Report, available at <http://www.tmx.com/en/news_events/exchange_bulletins/short_positions_2013.html>

12 Rule 10.10 Report of Short Positions, Universal Market Integrity Rules (UMIR), available at <http://www.iiroc.ca/industry/rulebook/Documents/UMIR1010_en.pdf>.

13 Investment Industry Regulatory Organization of Canada (IIROC), Short Sale Trading Statistics Summary, available at <http://www.iiroc.ca/news/Pages/Short-Sale.aspx>.

> At any time when I have a short position:
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> (a) any securities held by you for my Account other than an Account that is in a Locked-in Plan, may, without notice to me, be pledge or repledged by you as security for any of your indebtedness, whether for more or less than the amount due by me to you and either separately or together with other securities. *You may, without notice to me, loan such securities either separately or together with other securities.* I understand that *if such securities have been loaned over the record date, the number of securities you may vote (directly or indirectly) on my behalf or the number of securities I may vote may not be counted* and I agree to this risk associated with proxy voting; and
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> (b) any securities held by you for my Account other than an Account that is in a Lock-in Plan, *may, without notice to me, be used by you for making delivery against a sale, whether a short sale or otherwise* and whether such sale is for my Account or that of another customer, or for a sale to any account that you or your partners, officers or directors may have a direct or indirect interest in.[14]
>
> [emphasis added]

When a broker-dealer is considering lending securities, it looks to the aggregate available position it holds in that security. This aggregate available position will include the share positions in all its clients' margin accounts which are available for lending, as well as any position it holds on its own account. Because shares are fungible, it does not matter to the broker (or to the borrower of the securities) which securities it lends (or borrows). Rather, the records of the broker-dealer may state only that a certain number of shares out of the aggregate share position held in the broker-dealer's name have been loaned. The broker-dealer's records showing the position held for its own account and for clients will not necessarily change. If so, when the broker-dealer provides Broadridge with its (non-reconciled) beneficial owner data following the notice of record date, the broker-dealer's account will show that the margin account client continues to have a position in the loaned securities. In addition, the account of the borrower's broker dealer will also show that the borrower (or anyone to whom they have re-delivered the securities) has a position in the same securities. If ultimately left unreconciled, over-voting will occur.

In a comment letter to the 2011 OSC shareholder democracy notice, IIAC explained the standard industry practice among its members with respect to securities lending as follows:

> It has been incorrectly stated in public reports that shareholder lists produced by intermediaries are not reconciled and have not been adjusted to account for shares that have been loaned. In fact, our member firms have confirmed that standard industry procedure dictates that the lender is the beneficial holder of shares on

14 CIBC Investor Services Inc., CIBC Investor's Edge Account Agreements and Disclosures Booklet (January 2013), available at <https://www.investorsedge.cibc.com/ie/pdf/8278.pdf>.

> loan and is entitled to vote; and therefore will receive the VIF. Agreements exist with the beneficial holder (lender) of the shares that provide that they are able to vote on the position ONLY if the dealer can obtain a broker proxy or an omnibus proxy (from the borrower) to allow them to vote. If the dealer is unable to obtain such a proxy, the record date position held by the lender will be adjusted to reduce to shares on loan. A discussion on this issue among the largest IIAC retail members indicated that there is a general consistency between firms in terms of what process is used to reconcile accounts. Our members have dedicated resources to this process and take it very seriously. [15]

However, industry practice remains unclear as results of some academic studies[16] and the continued need for the Broadridge Over-Reporting Prevention Service suggest that most retail financial institutions in Canada do not reconcile their records until after VIFs have been returned to Broadridge.

In contrast to retail investors, many institutional investors utilize custodians to operate securities lending programs instead of brokers. However, we understand that custodians lend securities only for the accounts of, and on the instructions of, their clients (subject to a fee charged by the custodians). As a result, custodians do not loan securities from an aggregate position, shares that are loaned are marked on the client's accounts as being loaned, and the custodians therefore will not seek voting instructions from that client. In these circumstances, it would appear that institutional share lending via custodians would not contribute to over-voting. Commenting from a custodian perspective, Kathy Byles, Director, Compliance Americas, RBC Dexia said:

> We hear repeatedly that intermediaries are not balancing the lists that go out but we and our competitors find that perception incredible. The fact is that we all balance daily with CDS. Proxy or no proxy, we have robust systems and interfeeds that include automatic reconciliation. In addition, Broadridge has an overvoting correction system to which 97 per cent of Canada's intermediaries subscribe. Moreover our clients are very aware of their voting entitlements and if they feel the information they're receiving is inaccurate they let us know immediately.
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> To confirm this, we had a compliance audit specialist from our team examine 7,600 reports at Broadridge, of which 60 per cent balanced precisely. In 36 per cent of the cases, the voting list we provided to Broadridge showed our position was less than that of CDS. This is due to the fact that the foreign intermediaries for which RBC Dexia is subcustodian had been removed from the lists provided to Broadridge and subtracted from our total. We provide these institutions with an omnibus proxy so they can

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15 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_taylora.pdf> [**IIAC OSC Letter**].

16 Erin E. Smith, "Over-Voting" (February 9,2012) available at <http://www.stern.nyu.edu/cons/groups/content/documents/webasset/con_034305.pdf>.

> communicate with their underlying beneficial holders and tabulate their votes. The remaining four per cent exceeded the CDS total due to missing positions with DTCC, although these were identified and rectified.[17]

While these explanations are intended to mitigate over-voting concerns, we note that they do not address over-reporting and over-voting in circumstances that do not generate a vote total in excess of an intermediaries' CDS position. In addition, because the Broadridge Over-Reporting Prevention Service is provided free of charge, financial institutions have little incentive to implement costlier pre-mailing reconciliation policies and practices.

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.

(c) Need for Early Reconciliation

Intermediaries are required under IIROC rules and securities legislation to maintain accurate books and records of their securities transactions. However, securities laws and IIROC rules do not currently specify that a prescribed reconciliation or allocation methodology be performed in a particular manner in respect of a shareholders' meeting.[18] We understand that most intermediaries have developed a number of different approaches and adopted policies and procedures to address how votes are "allocated" among their client and proprietary accounts. The primary reconciliation methods were explained in the SEC concept release on various aspects of the U.S. proxy system (the **SEC Concept Release**).[19] We will use the same terms for the purposes of this response which are:

- pre-mailing reconciliation;
- post-mailing reconciliation; and

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17 RBC Dexia, A Case for Change: Shareholder Voting Symposium Summary Report (October, 2011) available at: <http://www.cscs.org/Resources/Documents/summit/Resources/RBC%20Dexia%20Shareholder_voting_report%20FINAL.pdf> [**RBC Dexia Report**].

18 Section 4.3 of Companion Policy to National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer* notes only that the records of an intermediary must be accurate. Intermediaries are currently not required to disclose their reconciliation method.

19 U.S., Concept Release on the U.S. Proxy System, U.S. Securities and Exchange Commission, Release No. 34-62495, (July 14, 2010), available at <http://www.sec.gov/rules/concept/2010/34-62495.pdf>.

- a hybrid form of the pre-reconciliation and post-reconciliation methods.[20]

Each approach has different implications as further described below:

- **Pre-mailing reconciliation.** The pre-mailing reconciliation method compares the number of shares the intermediary holds in aggregate at CDS and elsewhere with its aggregate customer account position before it sends VIFs to its customers. Intermediaries using the pre-mailing reconciliation method request voting instructions only from client positions to which votes have been allocated. If the aggregate number of shares held is less than the number of shares the intermediary has credited to its client accounts, then the intermediary will determine which of its clients will be permitted to vote and how many votes will be allocated to each of those clients. We understand that most intermediaries give clients with fully-paid securities and excess margin securities first priority in the distribution of votes.

  Some broker-dealers have indicated that the pre-mailing reconciliation method is more expensive than the post-mailing reconciliation method because post-mailing reconciliation only needs to be performed when a broker-dealer receives voting instructions in excess of the number of shares that it holds.

- **Post-mailing reconciliation.** The post-mailing reconciliation method occurs during the vote tabulation process, and compares the intermediary's aggregate CDS position to the aggregate client VIFs received from its clients.

  Intermediaries using the post-mailing reconciliation method request voting instructions from their clients with respect to all shares credited to their client accounts, including for those shares that may have been purchased on margin, loaned to another entity, or not received because of a "failure to deliver" problem in the settlement and clearance process. In the event that an intermediary receives voting instructions from its clients in excess of its aggregate securities position, the intermediary will adjust its vote count prior to the casting of votes with the issuer. Thus, voting positions under the post-mailing reconciliation method are reconciled only when the total instructed securities exceed the inventory held through CDS.

  The manner in which the adjustment is made varies among intermediaries. Because of the low level of participation by retail voters, some firms simply reduce the number of proprietary positions to redress any imbalance. Others allocate fewer votes to clients with securities purchased on margin or out on loan.

  The SEC Concept Release suggests that the post-mailing reconciliation method is favoured by intermediaries that have primarily retail clients rather than institutional clients because it provides greater flexibility in allocating votes to clients who have

20 *Ibid.*, at 32.

indicated a desire to vote. However, in our view, we do not think post-mailing reconciliation is an accurate term because it does not relate to a reconciliation of beneficial ownership records but rather represents an arbitrary decision on the part of the broker-dealer to allocate votes between various client accounts.

- **Hybrid reconciliation methods.** Some intermediaries have developed hybrid reconciliation methods that use aspects of both pre- and post-mailing reconciliation methods. For example, an intermediary may allocate votes to all of its clients with fully-paid securities but will also allocate any shares not needed to cover margin account holders who instructed the dealer they would like to vote, thereby giving these margin clients priority over other margin clients.

In response to the SEC Concept Release, the Weinberg Center convened a Roundtable on Proxy Governance[21] (the **Roundtable**) and prepared a report setting out its recommendations on the proxy voting system.[22] The goal of the Roundtable was to address existing concerns regarding the integrity of the shareholder voting process within the United States and to identify and develop realistic and achievable steps to strengthen the integrity of the entire process. While the Roundtable did not express an opinion regarding whether either reconciliation method is preferable, a number of tabulators indicated their preference for pre-mailing reconciliation stating that it informs investors with outstanding margin loans how many shares they are entitled to vote.[23] Some tabulators also claimed that pre-mailing reconciliation aids the tabulator in reconciling voting entitlements. The Roundtable noted, however, that any decision to mandate vote reconciliation by intermediaries would require action and rule-making by the SEC.

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21 The Roundtable on Proxy Governance is an industry group consisting of 33 members engaged in and knowledgeable about the shareholder voting process, including brokers, banks, issuers, tabulators, and investors.

22 University of Delaware John L. Weinberg Centre for Corporate Governance, Report of Roundtable on Proxy Governance: Recommendations for Providing End-to-End Vote Confirmation (December 13, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-300.pdf>.

23 In its response to the SEC Concept Release and the Roundtable report, the Securities Transfer Association, Inc. (STA) was firmly of the opinion that in order to have an unimpeachable voting result, there must be pre-reconciliation and a methodology for working through other depositories. See letter from Charles V. Rossi, President, Securities Transfers Association, Inc. to Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission, (February 16, 2012), available at <http://www.sec.gov/comments/s7-14-10/s71410-308.pdf>.

In addition, the Proxy Committee of the STA stated that, in order to establish a meaningful and operationally sound end-to-end vote confirmation system, the process should start with early stage establishment of voting entitlement. In support, the Proxy Committee held that "[i]n absence of this critical step, we would simply be adding yet another mechanical step to a basically flawed process which would still be subject to over-votes/over-reporting and the inconsistencies attached to their determination and reporting." See letter from Mario Passudetti, Chairman, Proxy Committee of Securities Transfer Association, Inc. to Maryellen Anderson, Broadridge Financial Services, (December 15, 2011), available at <http://www.sec.gov/comments/s7-14-10/s71410-306.pdf>.

(i) What is the most common reconciliation practice in Canada?

If an institution matches securities on loan to underlying client accounts before mailing voting materials (described as pre-mailing reconciliation above), over-voting is unlikely to occur with sufficient frequency to impact voting outcomes. However, we suspect that, because it is burdensome for the intermediary to link the lent share from a margin account to a particular client account, many intermediaries distribute proxy materials to all beneficial owners without reconciling outstanding loan positions to particular clients. These institutions practice "post-mailing reconciliation" whereby loan positions are reconciled only if the institution receives more VIFs than what is indicated by their CDS account.

(ii) Need for Regulatory Intervention

The integrity for vote counts at shareholder meetings can only have meaning if proxy materials and a request for voting instructions are sent only to eligible voters. As a first step, we believe that improvement in the effectiveness of the proxy voting infrastructure must start with more accountability for reconciliation of all voting rights, including reviewing client ownership data and making adjustments as necessary, before any beneficial ownership data files are transmitted to Broadridge for mailing. More specifically, intermediaries should be held accountable for reconciling the files of beneficial ownership data with their registered, depository and nominee positions as of the record date for each shareholder meeting, in order to avoid distributing proxy materials and VIFs to ineligible beneficial owners and to avoid discrepancies in tabulating final vote counts.

We believe the key reason for requiring reconciliations at the intermediaries' level is that, as a result of securities lending by intermediaries of securities held in margin accounts and of "failures to deliver", the number of shares credited on the books of some intermediaries to the account of some beneficial owners may exceed the number of shares credited on the books of CDS to the particular intermediary's account. As neither of these causes can be eliminated, we believe securities regulators should adopt amendments to NI 54-101 requiring pre-mailing reconciliation of beneficial ownership records to prevent over-voting.

As noted above, post-mailing reconciliation is a misleading term as it does not involve reconciling a share position to the true beneficial owner, but rather engineering a solution by allocating votes between different client accounts. It is better described as an after the fact remedy that permits generally low proxy voting response rates by retail investors to obscure excess vote problems within each intermediary's aggregate CDS position. Continued support for post-mailing reconciliation processes will only continue to legitimize this practice that permits votes to be counted from ineligible beneficial owner positions, with the corresponding risk that voting instructions from beneficial owners that have voting rights are not given their full weight at the shareholder meeting in question.

We submit that by requiring vote reconciliation practices earlier in the process, the stress of late-state, high-volume vote tabulating and reconciliation tasks can be materially reduced or eliminated. Pre-mailing reconciliation also has been described as having the following advantages:

- It makes the proxy voting infrastructure more verifiable, by requiring the compilation of a reconciled list of beneficial owners eligible to vote before proxy materials are distributed and votes are cast.
- It makes the proxy voting infrastructure more transparent to the extent that it ensures that beneficial owners know, at the time they vote, how many votes they are entitled to cast.
- It acknowledges the reality of securities lending and "failures to deliver" and attempts to deal with the consequences at the individual account level.
- It creates a standard method that is simple and more predictable due to the lack of subsequent readjustments.
- It places the beneficial owner in the same position as a registered owner by avoiding readjustments at a later date.
- It better respects the beneficial owner's decision to refrain from voting his or her shares, since those votes would not be reallocated to a different client.[24]

Pre-mailing reconciliation should not be difficult for intermediaries to implement operationally. While securities held through intermediaries are treated as a "fungible mass", all securities can be reconciled to an individual account when necessary, as required under securities regulation. The Companion Policy to NI 54-101 already provides that intermediaries' records must reconcile accurately with the records of the person or company through whom the intermediary itself holds the securities.[25] We also understand that a number of large broker-dealers in the U.S. have already successfully implemented pre-reconciliation procedures.[26]

The SEC Concept Release identifies that a potential disadvantage of pre-reconciliation is that this approach may cause an "under-vote" position. We submit that under-voting is not a problem

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[24] Letter from Jeffrey Rubin, Chair of the Committee on Federal Regulation of Securities, Business Law Section, American Bar Association to Elizabeth Murphy, Secretary, Securities and Exchange Commission (December 17, 2010), available at http://www.sec.gov/comments/s7-14-10/s71410-283.pdf **[ABA Letter]**

[25] Paragraph 4.3 of 54-101CP.

[26] See Letter from Thomas Gooley, Managing Director and Global Head of Operations, Morgan Stanley Smith Barney LLC to Elizabeth Murphy, Secretary, Securities and Exchange Commission (October 25, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-236.pdf>.

See also Securities Industry Association, *Suggested Practice Guidelines for Proxy Processing* (September, 2006), online: <http://www.sifma.org/uploadedfiles/issues/capital_markets/technology_and_operations/proxy/issues_technology%20and%20operations_suggested%20practice%20guidelines%20for%20proxy%20processing.pdf>.

that calls into question the integrity of the proxy voting infrastructure. Instead, it highlights the fact that some beneficial owners many not be participating fully in the proxy voting process and that, as a result, their custodial intermediaries may not be voting the total number of shares that they are entitled to vote in connection with a shareholder meeting.

In response to the SEC Concept Release, the Business Law Section of the American Bar Association (**ABA**) submitted that a mandatory pre-reconciliation system would create additional costs to intermediaries, including administrative costs and in terms of the relationship between beneficial owners and their custodial intermediaries. These relationship costs would be the result of beneficial owners knowing the effect of the pre-allocation methodology used by the broker-dealer. The ABA favoured disclosure to beneficial owners of the reconciliation method used by intermediaries to adjust their clients' accounts and how their voting instructions may be affected by the reconciliation method used.[27]

Whether or not the CSA mandates the use of a particular reconciliation method, it should at a minimum require intermediaries to disclose prominently the material aspects of the methodologies used to allocate and reconcile votes. In order for beneficial owners to have confidence in the proxy voting infrastructure, we believe they should at least understand how their voting instructions are reconciled by their intermediaries and whether it is possible that, as a result of a reconciliation, not all of the votes that are indicated on a beneficial owner's VIF will be cast as directed by that beneficial owner.

(d) Who Should Vote Borrowed Shares?

The CSA Consultation Paper also solicits public comments regarding which party (the lender or the borrower) should have the right to vote in a share lending transaction. As we note below, borrowed securities are typically characterized as a legal transfer of securities under Canadian securities law and in international practice. However, model share lending agreements available through IIROC take an alternative approach to this issue, which we submit may result in a degree of market confusion.

Although securities lending transactions are commonly described as "loans", this description may be misleading as such transactions, in fact, involve a transfer of title to the loaned securities against a collateralized undertaking to return equivalent securities either on demand or at the end of an agreed term. Usually the borrower will collateralize the transaction with cash or other securities of equal or greater value than the lent securities in order to protect the lender against counterparty default. The fees charged, along with all other aspects of the transaction, are dealt with under the terms agreed between the parties. It is entirely possible and very commonplace that securities are borrowed and then sold or lent to another third-party.

Consequently, as the new owner of the securities, the borrower is legally entitled to vote the securities and receives any dividend or interest payments paid during the loan term. If the lender

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27 ABA Letter, supra note 24.

wants to vote the loaned securities, it may have the right to recall equivalent securities from the borrower but will not be entitled to vote such securities unless and until they are recalled. This position has been endorsed by Canadian securities regulators, who in March of 2013 sought to clarify current securities laws that require not only that a borrower account for securities "borrowed" under a securities lending arrangement for the purpose of determining whether it has crossed an early warning reporting disclosure threshold, but also that the "lender" must take into account securities loaned out when determining ownership levels. [28] This approach would also appear to be consistent with the characterization of securities lending under applicable regimes in the U.S.,[29] the United Kingdom,[30] and internationally.[31]

However, the IIROC model securities loan agreements take a different approach. These agreements note explicitly that the delivery of "loaned securities" to the borrower by the lender "shall constitute a loan, not a sale or other disposition", and that "beneficial ownership of the Loaned Securities shall not pass to Borrower upon Delivery of the Loaned Securities".[32] Moreover, the model agreements note that while a Borrower shall have all incidents of ownership of the "loaned securities", including the right to transfer the "loaned securities" to others, it nevertheless explicitly reserves the right to vote to the Lender:

> Borrower acknowledges and agrees that all voting rights, options, conversion privileges and other rights or benefits attaching to the Loaned Securities accrue to Lender as legal and beneficial owner of the Loaned Securities as if the Loaned Securities had not been lent by Lender to Borrower; and Borrower shall exercise all such rights and privileges for and on behalf of Lender in accordance with the written instructions of Lender. Such written instructions of Lender must be actually received by Borrower at least five (5) business days prior to the final date for the taking of any action required to exercise such right or privilege, or, for

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28 See *CSA Notice and Request for Comment on Proposed Amendments to Multilateral Instrument 62-104 Take-over Bids and Issuer Bids, National Policy 62-203 Take-Over Bids and Issuer Bids, and National Instrument 62-103 Early Warning System and Related Take-Over Bid and Insider Reporting Issues* dated March 13, 2013 (2013) 36 O.S.C.B. 2675 at 2680.

29 SEC Concept Release, *supra* note 19.

30 Mark C. Faulkner, Spitalfields Advisors, *Securities Lending and Corporate Governance* (2005) available at <http://www.canseclend.com/tiny_mce/plugins/filemanager/pics_cms/8/8/Introduction_to_Securities_Lending_Canada.pdf>.

31 In 2007 International Corporate Governance Network adopted its *Securities Lending Code of Best Practice*, which notes that all share lending activity should be based upon the realization that lending inherently entails transfer of title from the lender to the borrower for the duration of the loan. Available at www.icgn.org.

32 See, section 2.3 of Securities Loan Agreement (with set-off), available at <http://iiroc.knotia.ca/Knowledge/View/ViewAttachment.aspx/SS%20-%20Securities%20Loan%20Agreement%20-with%20set-off-_en%20-%202007Jun13.pdf?kType=445&dBID=201210359&ftID=SS%20-%20Securities%20Loan%20Agreement%20-with%20set-off-_en%20-%202007Jun13.pdf>.

> other than voting rights, such lesser period of notice as the relevant regulatory authority may prescribe for the trading and settlement of securities in connection with the exercise of such right or privilege as if Lender were a member who failed to receive. All such notices shall be given in the normal manner and in sufficient time to allow Borrower to act accordingly. [33]

In our view, the approach adopted in the IIROC model agreements is troubling as it remains out of keeping with international practice. We also note that any arrangement that permits the borrower to sell the loaned securities to a unsuspecting third party but that reserves the right of the lender to vote such shares is, in fact, a recipe for over-voting. We would therefore encourage the CSA to consider this issue further.

2. Restricted Proxies as a Contributor to Over-Voting

As described in the CSA Consultation Paper, a **restricted proxy** refers to a proxy used by an intermediary to directly submit proxy votes to the tabulator (i.e., outside the tabulation reports generated by Broadridge) on behalf of a client for whom it holds shares or provided by the intermediary to the beneficial holder.

One transfer agent we contacted described the most common scenario where a restricted proxy is requested as one where a shareholder (most often a large holder and sometimes an insider of the issuer) contacts their broker to demand a proxy so they can vote directly or attend the meeting in person. The shareholder may not have received a VIF, lost it, or forgotten that they received it (and in some cases, already voted it). In other scenarios, the shareholder may have OBO status and declined to receive meeting materials for shareholder meetings but nevertheless decided that it would like to vote at the upcoming shareholder meeting. In these circumstances, the broker would give that account holder a restricted proxy that allows them to vote, by submitting it to the tabulator and either voting or appointing themselves to attend the meeting in person.

The transfer agent also advised us that restricted proxies are usually requested for large numbers of shares. Sometimes the tabulator can easily determine that the vote has been cast both through Broadridge and via a restricted proxy. For example, if the intermediary holds 500,000 shares and the restricted proxy is for 500,000 shares, and both are voted, the tabulator will clearly see there has been a duplication of the vote. On the other hand, if the intermediary holds 10,000,000 shares, it will be impossible to determine if a potential over-vote is related to the granting of a restricted proxy. We have also been advised that transfer agents do not receive restricted proxies as often as they used to, but they are still a source of issues related to tabulating the votes.

The intermediary is responsible for recording the fact they have granted a restricted proxy and making the adjustments necessary to the records sent to Broadridge. This adjustment in Broadridge's records will, reduce the votable position for that intermediary, block the account from being voted through Broadridge, or depending on whether voting instructions have already

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33 *Ibid.*, sections 6 and 7.6.

been received by Broadridge, revoke any vote that may already have been recorded and reported by Broadridge and transmit that revocation in the next "Vote Report" provided to the official tabulator. Broadridge has no role in issuing restricted proxies and would not know whether a restricted proxy was issued.

If the account holder is a NOBO holder and the issuer has elected to communicate directly with NOBO holders, the intermediary cannot (or should not) provide a restricted proxy, because the voting entitlement has already been passed to management of the issuer via an omnibus executed by Broadridge. The issues arise with the tabulator because either the intermediary has not adjusted and coded the account on Broadridge systems as having received a restricted proxy or the broker does not check if the account holder is a NOBO holder and NOBO data and voting entitlement has been passed to the issuer.

While the use of a restricted proxy, *per se*, may not be problematic, any failure by an intermediary to ensure the voting records are adjusted appropriately can lead to over-voting. We recommend that the CSA further investigate how often tabulation issues arise in connection with restricted proxies.

3. Omnibus Proxies and Discarded Votes

We agree with the statement in the CSA Consultation Paper that missing or incomplete omnibus proxy documentation can be problematic for the integrity of the proxy voting system. Based upon our understanding of the system, this problem typically arises as a result of the incorrect coding of omnibus accounts by financial intermediaries. 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.

We do not have quantitative data to determine exactly how often these issue arise, however anecdotally we understand that these issues are not uncommon.

(i) How Omnibus Proxies are Used

As noted in the CSA Consultation Paper, an omnibus proxy (the **CDS Omnibus Proxy**) is originally created when CDS (as registered shareholder) transfers its authority to vote in person or by proxy to each CDS participant in respect of the shares that the CDS participant holds in its account with CDS. Broadridge receives CDS Omnibus Proxy data for those intermediaries that have authorized CDS to provide that data to Broadridge, based on which Broadridge creates the initial record of "votable positions" in its system.

Shortly after the announcement of the record date, Broadridge will send a communication to all of its intermediary clients in North America indicating the record date and "triggering" those intermediaries that hold an interest in the reporting issuer to provide their beneficial holder data to Broadridge.[34] In the hypothetical example attached in Appendix A, Broadridge would send a trigger communication to each of RBC, Merrill Lynch and Citibank, and would receive beneficial holder data directly from each of those intermediaries in return. The data provided from the intermediaries must indicate, by way of "coding", which shares are held by the intermediary on behalf of other intermediaries by way of an omnibus account. In the example provided, RBC's financial data submitted to Broadridge would indicate that the 5000 shares are held in an omnibus account for the benefit of Merrill Lynch.

Upon receipt of this information, Broadridge will issue a "mini-omnibus" proxy and will adjust the CDS Omnibus Proxy accordingly. In our example, RBC's position in the CDS Omnibus Proxy will be reduced by 5000 shares, while Merrill Lynch will be issued an mini-omnibus proxy for 5000 shares. This process will be repeated as necessary down the chain (so, upon the receipt of information from Merrill Lynch, its mini-omnibus proxy will be reduced by 4000 shares, and a mini-omnibus proxy will be issued to Citibank for 4000 shares).

Ultimately, each intermediary will forward to Broadridge any votes it receives for its beneficial owners (again, in our example, RBC, Merrill Lynch and Citibank will each transmit voting information for its account holders – other than omnibus account holders – directly to Broadridge). Ultimately, the meeting tabulator must be able to determine that any votes it receives (via Broadridge or otherwise) corresponds to an omnibus proxy or a mini-omnibus proxy (e.g., the tabluator must ultimately be able to compare the number of votes submitted by RBC against the RBC position indicated in the adjusted omnibus proxy). Any votes in excess of that position would indicate "over-voting", and would trigger a need for RBC to reconcile its records.

Broadridge does not and cannot determine whether beneficial holder files provided by intermediaries are properly coded as an omnibus account. If an intermediary fails to code an omnibus account properly, Broadridge would receive votes from those intermediaries lower in the chain, but would have no way of reconciling those votes to a proxy, leaving Broadridge and any subsequent transfer agent unclear as to the authority from which the votes originated. If such authority cannot be determined by the time of the meeting, there may be little choice but to discard such votes.

Careful attention to the coding of omnibus accounts by intermediaries, together with ongoing education to ensure that all parties understand the importance of such coding, would clearly go a long way towards addressing the problems associated with omnibus proxies. Nevertheless, it is unlikely that this problem can be entirely eliminated, as it is inherent to the indirect ownership method.

We also understand that "mini-omnibus" proxies are routinely issued in physical form through fax or a .PDF file, as a result of the different technology platforms used by various market

[34] Pursuant to section 4.1 of NI 54-101, the response to the "trigger communication" must be sent within three business days of receiving the request for beneficial ownership information.

participants. This situation is clearly not ideal, however we understand that Broadridge and Computershare in Canada are piloting an electronic file transmission of this data this year.

4. Other factors and related issues

We believe that other factors may also contribute to vote reconciliation issues, such as communication discrepancies between CDS, DTCC and the intermediaries for issuers whose shares are clearing through both depositories. An imbalance between a intermediary's position reflected on the CDS records and the position reflected in its own books and records may also occur because of failures to deliver in the clearance and settlement system. These discrepancies, however, are often resolved before proxy materials are mailed.[35]

We are concerned about any circumstance in which a share can be voted more than once and encourage the CSA to focus more broadly on all of the circumstances in which this can occur.

In addition, we have also been advised by one party that proxy voting "cut-off" dates for Canadian issuers have been growing in recent years, from one or two days before a meeting to three or even four days before a meeting. We understand that this trend is in contrast to the trend in other jurisdictions, where proxy-voting cut-off dates have been moving closer to the meeting date. We have been unable to determine a reason for such a development in Canada, but note that if true such a trend would be worrying, as it could lead to potential undue disenfranchisement of the shareholders.

5. Need for Greater Accountability

As noted above, the failure to maintain appropriate records and to follow appropriate internal process may result in over-reporting and over-voting. One effective remedy for such failures may be increasing the level of accountability of intermediaries and other system participants, by making them subject to securities regulation and more directly accountable for their record keeping processes.

(a) Service Providers as Market Participants

As noted in the CSA 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.

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35 For example IIAC notes that an issue which has been consistently identified by its members as a suspected major contributing factor to the appearance of over-reporting is a communications problem involving CDS, DTC and the various intermediaries. In a preliminary survey conducted by a few of its largest members, IIAC states that this problem could account for as much as 90% of the instances in which over-reporting appears to exist.

See IIAC OSC Letter, *supra* note 15 at 11-12.

Moreover, some of these parties can play multiple roles within the system: for example, transfer agents frequently act as tabulators and scrutineers at corporate meetings.

While certain service providers are currently subject to some degree of regulation,[36] no single regulator is responsible for the oversight of all players within the system. We consider this to be problematic, as it makes regulatory monitoring of compliance within the system difficult if not impossible.

In our view, this problem can be rectified by designating all major service providers as "market participants" within the meaning of securities legislation. For example, under the Ontario *Securities Act* (**OSA**), an entity that is a "market participant" is subject to certain specific provisions of securities law, namely:

- the Ontario Securities Commission (the **OSC**) may order such examination of the financial affairs of a market participant as it considers expedient "for the due administration of Ontario securities law or the regulation of capital markets in Ontario";[37]

- market participants are required to keep books and records for the proper recording of their business transactions and financial affairs and the transactions they execute on behalf of others and must provide them to the OSC upon request;[38] and

- the OSC may make an order "that a market participant submit to a review of his, her or its practices and procedures and institute such changes as may be ordered by the Commission".[39]

Designation as a market participant would bring each party within the jurisdictional scope of a single regulator (in this case, the OSC), allowing the regulator to access information about the party. At the same time, it represents a limited regulatory burden to be imposed upon these parties. Such a designation could be done either by statutory amendment or by way of rule-making. In the end, we believe that this remains a crucial first step in ensuring the accountability of all major participants in the proxy voting infrastructure.

36 Some entities, such as depositories and certain financial intermediaries (e.g., brokers) are currently subject to securities regulation. Other entities may be subject to a degree of supervision by other regulators, but their role within the proxy voting system may not necessarily be supervised (e.g., custodians, which in Canada are all banks or trust companies, are subject supervision by the Office of the Superintendent of Financial Institutions or similar provincial regulators, that do not provide meaningful oversight of an organization's role as custodian).

37 OSA, section 12.

38 *Ibid.*, section 19. The Commission may also conduct a comprehensive compliance review of these books and records under section 20.

39 *Ibid.*, section 127.

(b) Audits

While many of the participants in the proxy voting infrastructure currently audit their systems (whether for themselves or to report to clients), there is no process by which the system as a whole is audited to provide assurance that only those beneficial owners who are entitled to vote receive VIFs and that their votes are given their full weight at each meeting. We believe an "end-to-end" operational 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.

However, we question whether the OSC or any other regulator would have the financial and human resources to effectively conduct such routine audits. As a result, securities regulators should also consider alternative mechanisms which could provide all participants with sufficient comfort that the proxy infrastructure system is working as it was intended.

We would suggest 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. 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. The quarterly certification 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 possible over reporting situations. In this way, effective enforcement and compliance is best served by preventing non-compliance rather than identifying and dealing with non-compliance after the fact.[40]

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, which will in turn facilitate the reduction of the occurrences of over-voting.

We acknowledge that intermediaries may be reluctant to adopt such a requirement for fear of being held liable for any mistakes in their own record keeping or for errors contained in data provided to them by third parties. However, we submit that this need not be the case, and that a certificate could be created to reflect that the certifying officer has designed systems to provide "reasonable assurance" that their beneficial ownership information is accurate and reconciled for

[40] Computershare OSC Letter, *supra* note 8 at 4.

each applicable record date. Such an approach would ensure that the record keeping of intermediaries is not held up to a standard of perfection.

The quarterly certification requirement should be imposed regardless of whether securities regulators mandate a particular pre-mailing reconciliation approach. Similar to the regulatory approach taken in National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* for reporting issuers, certification would require intermediaries to disclose their conclusions about the effectiveness of their reconciliation policies and practices and remediate any control deficiencies. We believe it is more cost effective to impose these compliance requirements on intermediaries who are already subject to NI 54-101, as opposed to urging that securities regulators complete and report the results of annual (or spot) audits of intermediaries' compliance with NI 54-101.

B. End-to-End Confirmation

We believe that is it important that beneficial holders receive confirmation from the issuer (through intermediaries as appropriate) that their voting instructions have been received and properly recorded at a meeting, and that the votes cast have been given their full weight. We note that casting votes into a system that is unable to confirm votes and has no group or body assuming ownership over systemic integrity is fundamentally flawed and dilutes, or in some cases eradicates, the shareholder's right to vote.

(a) Current Lack of Meaningful Confirmation

Institutional investors use a variety of methods to access the proxy voting infrastructure, such as directly through Broadridge's proprietary platform ProxyEdge® (**ProxyEdge**), by way of custom data feeds provided by Broadridge, or via a platform offered through a proxy service provider.

ProxyEdge provides proxy information to institutional investors through an automated electronic interface based on share positions provided directly to Broadridge by a custodian. For positions not held through a Broadridge client, Broadridge can take holdings directly from an investor to provide a comprehensive view on ProxyEdge of all positions for that investor.[41] An institutional investor can log on to ProxyEdge to access meeting materials, to cast their votes and to receive "confirmation". However, at present, Broadridge can only routinely confirm to an investor that its voting instructions have been received by Broadridge and forwarded to the tabulator. There is no confirmation that the tabulator ultimately received, accepted and tabulated the vote as instructed. As a result, even though a vote has been "confirmed", an investor has no way in which to determine if its votes were cast, or if they were ultimately diluted through over-voting or perhaps even entirely discarded by the tabulator.

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41 Broadridge Financial Solutions, Inc., ProxyEdge®, (last visited November 12, 2013), available at <http://www.broadridge.com/mutual-fund-retirement-solutions/proxy-regulatory/institutional-voting/proxyedge>.

Not all institutional investors use ProxyEdge to manage their proxies processes. For example, an investor may receive "custom" data feeds directly from Broadridge. Other investors utilize the services of Institutional Shareholder Services Inc. or Glass, Lewis & Co., which operate proprietal 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.

During our recent discussions with Broadridge, we were advised that, starting November 5th, Canadian custodians are now able to provide vote confirmations for issuers offering the end-to-end vote confirmation functionality. However, in its current form, this end-to-end 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. In Canada, only the official tabulator, which is typically the issuer's transfer agent, can confirm that a vote has been received, accepted and voted at a meeting. We are not aware of any Canadian reporting issuer, as of this time, as having designated Broadridge to act as tabulator for a shareholder meeting.

While some of the current developments in the U.S. and Canada are encouraging, there are several challenges which need to be addressed in both markets before end-to-end vote confirmation can be broadly relied upon by investors.

The first challenge relates to difficulties in implementing the end-to-end vote confirmation service for shareholders who use voting platforms other than Broadridge's, as well as to issuers who utilize other meeting tabulating agents. We question whether any end-to-end vote confirmation solution which relies upon Broadridge being "master" tabulator and distributor of all materials represents an appropriate solution for the Canadian marketplace. However, we also understand that Broadridge has taken steps to extend their end-to-end vote confirmation service to include "... shareholders who use voting platforms other than Broadridge's as well as to issuers who utilize other meeting tabulating agents." For example, we have been advised by Broadridge that four transfer agents in the U.S. will participate in a pilot initiative for the 2014 proxy season with approximately 20 issuers. We also understand that transfer agents need to implement new IT communication tools that deliver acceptance and rejection data and a description of the issue(s) behind any rejection. Wide acceptance of Broadridge's service will not be forthcoming until these issues and concerns are resolved.

The second challenge relates to a lack of adoption of the end-to-end vote confirmation service from the issuer community. In its current form, the reporting issuer must request the end-to-end vote confirmation service for its shareholder meeting. We have been advised by Broadridge that of the approximately 1900 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. Vote confirmation by investors should not rely on opt-in by the issuer.

(b) What functionality should be part of an end-to-end vote confirmation system?

As a starting point, we believe the integrity of any end-to-end vote confirmation service relies on early reconciliation of each intermediary's beneficial ownership data prior to providing those records to Broadridge. As described above, unless each intermediary's ledger positions are reconciled prior to mailing, the voting instructions sent through the proxy voting infrastructure will be inaccurate and the integrity of any vote will be brought into question.

In our view, 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:
    - i) The voting instructions have been received by the tabulator
    - ii) The voting instructions have been accepted and processed by the tabulator, as instructed by the investor, and
    - iii) 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.

We believe that private sector efforts to provide an end-to-end vote confirmation solution are commendable. However, we also believe 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.

C. The OBO/NOBO Debate

One of the hallmarks of the Canadian and U.S. proxy voting regimes is that beneficial shareholders may elect to conceal their identity from an issuer by designating themselves as an "objecting beneficial owner" (or **OBO**) rather than a "non-objecting beneficial owner" (or **NOBO**). Yet this ability of investors to maintain their anonymity is not free from controversy, and a number of commentators have suggested that the designation of investors as OBOs should be eliminated. Much of this public debate, however, has occurred 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 by the CSA Consultation Paper do not address shareholder communication; instead, the CSA has commenced its review to consider the integrity of the proxy voting system. While the OBO/NOBO designation may complicate the proxy voting system, we suggest that it does not necessarily stand in the way of reforms to the system designed to ensure the proxy voting system operates efficiently and with integrity.

(a) Implications of being an OBO

The single biggest implication of being an OBO is that one's identity is not disclosed to the issuer, unless disclosure is otherwise necessary under securities law.[42] However, this is not the only implication. For example, while the issuer is responsible for the cost of mailing to its registered holders and its NOBOs, it is not required to pay the costs associated with the delivery of proxy materials to OBOs. As initially conceived, this was intended to provide a "cost" to maintaining anonymity, and has been likened to the cost of having an unlisted phone number.[43] However, the cost of providing these services has not generally been passed on to the OBO, but instead has been absorbed by either the reporting issuer or intermediaries. Nevertheless, it remains possible that if neither the reporting issuer nor the intermediary is willing to pay such costs, OBO investors may simply not receive the proxy voting materials.[44]

(b) Why Would an Investor Want to be an OBO?

Why would an investor choose to be an OBO? Reasons for choosing this status can vary, depending upon the nature of the investor in question.

A retail investor might opt for OBO status simply to maintain his or her privacy, though many retail investors also choose OBO status to avoid opening themselves up to further solicitations

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42 For example, section 102.1 of the OSA requires any investor to publicly disclose its share ownership if it acquires beneficial ownership of, or the power to exercise control or direction over, voting or equity securities of any class of a reporting issuer or securities convertible into voting or equity securities of any class of a reporting issuer that, when added to the acquiror's securities of that class, would constitute 10 per cent or more of the outstanding securities of that class.

43 Davies Paper, *supra* note 5 at 75.

44 While the issue of non-delivery of proxy materials remains a potential issue for OBOs, we note that especially in the case of larger companies, the issuer typically paying the cost of delivery. In addition, as noted below, most institutional investors obtain their proxy materials through ProxyEdge or through another service provider. As a result, the issuer of non-delivery of proxy materials is not likely significant.

and communications from the issuer.[45] However, it remains unclear how many retail investors are fully informed regarding their choice. A study[46] of retail investors from 2006 found that over half of the respondents could not remember being asked whether they wanted their contact information provided to companies whose stock they purchased, and of those who could recall being asked, nearly 80% would be willing to provide their name and contact information to the issuer. Furthermore, having been given a comprehensive explanation of the difference between OBO and NOBO status, 64% of those surveyed noted they would choose NOBO status, with a more significant decline in those choosing OBO status if an annual fee was also charged.

Institutional investors have traditionally been supporters of the OBO/NOBO distinction. The primary purpose many institutional investors support this approach is that it preserves their anonymity, as OBO status allows them to keep their holdings and proprietary trading strategies confidential from not only competitors,[47] but also from other individuals that might attempt to "front run" the investor's trading strategies or otherwise reverse engineer its tactics, either of which could result in an adverse impact on the investor.[48]

However, in a report that reviewed comment letters provided in response to the SEC Concept Release, The Altman Group noted that letters to the SEC from the institutional investment community reflected a range of opinions.[49] For example, the Comptroller's Office for the City of New York, which is a trustee of four of the five New York City pension funds, and the investment advisor to all five Funds, argued that "the right of beneficial owners to object to having their identities disclosed to issuers should not be abridged".[50] In contrast, the California State Teachers' Retirement System (**CalSTRS**) suggested that the interest of shareholders and issuers in better communications is more important than the ability to preserve investor privacy

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45 Allen Beller and Janet Fisher, *The OBO/NOB Distinction in Beneficial Ownership: Implications for Shareowner Communication and Voting* (February, 2010), prepared for the Council of Institution Investors, available at <http://www.cgsh.com/files/Publication/ece76691-81b4-4691-a666-a1f361407dbb/Presentation/PublicationAttachment/a2c899f9-c54f-415a-8cd7-aac4eae5aeb7/CII%20White%20Paper%20-%20The%20OBO-NOBO%20Distinction%20in%20Beneficial%20Ownership%20February%202010.pdf>.

46 Investor Attitudes Study conducted for NYSE Group, prepared by Opinion Research Corporation dated April 7, 2006, available at <http://www.nyse.com/pdfs/Final_ORC_Survey.pdf>.

47 Beller and Fisher, *supra* note 45 at 12

48 Letter from Keith Bozarth, Executive Director, State of Wisconsin Investment Board to Elizabeth Murphy, Secretary, Securities and Exchange Commission (October 20, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-113.pdf>.

49 The Altman Group, Special Report: OBO/NOBO Reform: Analysis of Comments Submitted to the SEC in Response to the Concept Release on the U.S. Proxy System, (December 13, 2010), available at <http://www.altmangroup.com/pdf/TAGSpecialReportOBO.pdf> [**Altman Paper**].

50 Letter from Michael Garland, Executive Director for Corporate Governance, New York City Comptroller to Elizabeth Murphy, Secretary, Securities and Exchange Commission (October 20, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-283.pdf>http://www.sec.gov/comments/s7-14-10/s71410-187.pdf>.

through the OBO/NOBO regime, though CalSTRS did believe that investors who wanted to maintain their privacy should have that choice and the costs associated with the distinction should be borne by the investor. CalSTRS noted that concerns regarding confidentiality may have waned because over the last two decades there have been enormous changes in the voting system, including the requirement that registered investment management companies disclose how they vote portfolio securities.[51] However, we note that in Canada, no similar disclosure requirement exists for investment managers.

In jurisdictions in which there is no OBO/NOBO concept (essentially everywhere except the U.S. and Canada), institutional investors may take other measures to preserve their anonymity, such as holding their investment through holding companies and nominee accounts. Not all jurisdictions permit such measures. As noted by Standard Life Investments in a letter submitted to the SEC:

> We believe that issuers should be empowered to interrogate those names appearing on their share register to identify actual owners of the company concealed by the use of brokers' or banks' names on the accounts. In the United Kingdom for example, the company has the right to disenfranchise shareholders of voting rights who do not respond to the issuer's inquiries as to their identity, as well as to suspend other rights, such as the dividend and any other special benefits accorded to shareholders. We feel that concerns of transparency, good corporate governance, and shareowner stewardship have now become paramount, and that communication between a company and its owners should be privileged over the ability to keep one's identity a secret. [52]

(c) Issuer Opposition to OBO/NOBO Distinction

Although there may be a diversity of opinion regarding the appropriateness of the OBO/NOBO distinction amongst investors, the same may not be the case with issuers. For example, of those issuers that provided responses to the SEC Concept Release, nearly all supported the elimination of the OBO/NOBO distinction.[53] Generally speaking, these commenters believed that they should have access to the identity of their investors, and be permitted to contact those shareholders as appropriate.

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51 Letter from Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System Investments to Elizabeth Murphy, Secretary, Securities and Exchange Commission (October 19, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-147.pdf>.

52 Letter from Douglas Wilson, Corporate Governance Manager – Voting, Standard Life Investments to Elizabeth Murphy, Secretary, Securities and Exchange Commission (October 20, 2010), available at <http://www.sec.gov/comments/s7-14-10/s71410-102.pdf>.

53 See Altman Paper, *supra* note 49.

(d) Does the OBO/NOBO Distinction Complicate the Proxy Voting System?

The appropriateness of the OBO/NOBO distinction continues to be debated, and was an important element of the discussion encouraged by the SEC Concept Release. However, it should be noted that this debate has frequently occurred in the context of "improved shareholder communication" rather than in the context of "system integrity". While the manner of shareholder communication (and the corresponding level of investor transparency) remains an important question, it is nonetheless separate and distinct from the question of the integrity of proxy voting system, and should be examined separately.

That said, there can be no doubt that the maintenance of the OBO/NOBO distinction further complicates a proxy voting regime already convoluted by intermediation and its multiple levels of legal and beneficial ownership. However, as noted in the recent CSA Consultation Paper, a complex system does not necessarily lack integrity.[54] Moreover, while there continues to be a significant debate concerning shareholder communication in general, and the appropriate level of investor transparency in particular, it does not appear that the OBO/NOBO distinction itself may be impediment to an efficient and reliable proxy voting system. We note that measures such as mandatory pre-mailing reconciliations by intermediaries would not require a change to the OBO/NOBO system. Similarly, the implementation of an end-to-end vote confirmation system would not necessarily require OBOs to disclose their identity, as a system could be conceived that utilized confidential control numbers instead of names to identify the appropriate investors and their accounts.

Moreover, it is likely 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. 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 plumbing point of view, the removal of the OBO concept would only 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 costs savings by issuers must be contrasted against those costs to be incurred by institutional investors who would need to restructure and maintain their holdings through nominee accounts in order to preserve their anonymity.

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We would once again like to thank the Canadian Securities Administrators for publishing the CSA Consultation Paper and seeking to advance discussions surrounding the proxy voting

[54] CSA Consultation Paper, (August 15, 2013), 36 OSCB 8130 at 8133.

system in Canada. If you would like to discuss any of our comments, or if we can be of any further assistance to you, please do not hesitate to contact the undersigned.

Yours very truly,

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APPENDIX A

Example of Ownership Structure