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October 20, 2010

Delivered by email

Attention: Elizabeth M. Murphy, Secretary, Securities and Exchange Commission

Re: File Number S7-14-10
Concept Release on the U.S. Proxy Voting System

The **Canadian Society of Corporate Secretaries (CSCS)** engages with relevant securities regulators to ensure our members' interests are represented. The proxy voting systems in both Canada and the US are in need of both updating and simplifying. CSCS is paying close attention to the developments in the US. We congratulate the Securities and Exchange Commission (SEC) for being the first North American regulator to propose a serious review and revisions to a system that is incredibly complicated and frustrates the abilities of both shareholders and issuers to communicate effectively.

CSCS is a vocal proponent for reform of the proxy voting system in Canada. As that topic is more relevant to our members, we will limit our comments on the SEC concept release to an area where US regulation could significantly impact our members – the role of proxy advisory firms in the proxy voting process.

Background

Proxy advisory firms play a significant role in the integrity of the proxy voting process throughout North America and it is a role that CSCS members want to ensure is addressed in any overhaul of the US proxy voting system.

All of the proxy advisory firms provide voting recommendations on Canadian issuers as well as US issuers. This advice is provided to the proxy advisory clients (institutional investors) who then vote in accordance with the recommendations or apply their own voting policies to the issues identified.

CSCS held a teleconference call with interested members who had come forward asking to discuss this issue in light of the SEC concept release. During the call, we reviewed the specific impacts of proxy advisory firms on Canadian companies and reviewed the main concerns of Canadian issuers.

Key Concerns

There are three main concerns that CSCS members identified with the current regime for proxy advisory firms.

1. **Substantial influence without oversight or economic interest.**

   Proxy advisory firms have a significant impact on how institutional shareholders vote – often swaying the vote by more than 20% (based on individual company reviews of voting patterns). This means that a negative recommendation from any or all of the proxy advisory firms can result in an issuer's directors not receiving majority votes, option or shareholder rights plans not being approved and corporate transactions failing to achieve the required shareholder approval.
   In this age of shareholder democracy that might not seem significant, until you consider the following:

   - **There is little to no oversight of proxy advisory firms.** – As noted in the release, current regulation does not require that most proxy advisory firms register with the SEC and there is very limited regulatory oversight of an industry that has significant ability to shape North America's corporate landscape. Only those registered as investment advisors (and most are not) must designate a chief compliance officer to oversee their compliance programs or establish policies and procedures to prevent the misuse of material non-public information.

   - **There is no requirement that proxy advisory firms ensure that they have accurately interpreted an issuer's data.** – If a proxy advisor is deemed to come under the Advisers Act it must adopt rules to prevent fraudulent, deceptive or manipulative business practices. This leaves a large gap if information is negligently erroneous, but not intentionally fraudulent, deceptive or manipulative. All of the CSCS members who participated on the conference call confirmed that they have frequently found errors (some, finding errors every year) in the data or interpretation underlying the voting recommendations of the proxy advisors. Some proxy advisors indicate that they provide the information to issuers to review for accuracy each year. However, based on our members' experiences, this is only true for some companies – generally those who follow up every year and request the information. Given that data may be incorrect at a significant number of companies (100% in our sample) almost every year, the recommendations being made by the proxy advisors are at least based on false assumptions and at worst may be frustrating the underlying objective of long-term shareholder growth.

   - **There are no consistent processes for companies to ensure corrections to erroneous information.** – Once an error is identified by an issuer, there is no documented process they can follow to ensure that the error is corrected. In some cases it cannot be corrected in a timely manner and the erroneous recommendation is released and then only amended later. In addition, it does not appear that the institutional investors are consistently advised when a correction has been made. Given that many institutions vote hundreds of proxies each day during the busiest proxy-voting times, it is doubtful that they will vote with the correct information in hand if they do not receive effective notification of amendments. This leaves any corrections to be done via one-to-one calls from the company or its proxy solicitor to each institution to see if it can rectify the situation. One proxy advisory firm refuses outright to speak to any issuer during the proxy voting season making it impossible to have corrections made.

- **One-size fits all approach.** – Each proxy advisory firm has its own set of criteria and standards that they apply consistently without regard to the circumstances of a specific company. Even if differences are recognized for certain sectors, in some cases cited by CSCS members, companies are grouped with dissimilar peers, making the standards that apply to them inappropriate. For example, mining companies may be grouped by some proxy advisors into a general industry sector that does not fit them.

- **The voting recommendations may be poor, at best.** Recommendations are based on what the proxy advisor considers current "best practices," many of which go beyond regulatory requirements and may be in direct conflict from one advisory firm to the next. Nevertheless, issuers are under extreme pressure to adopt these best practices (and do so) in order to ensure that they get positive vote recommendations from the proxy advisory firms. The best example of this is a number of companies who removed former Chief Executive Officers (CEOs) of the company from their Audit Committees. Those CEOs were independent under regulatory standards after a cooling off period of three years. However, this rule was not acceptable to at least one of the proxy advisory firms. As a result, Audit Committees lost valuable expertise and shareholders lost engaged representatives. Current research indicates that most governance initiatives have little impact on company success – one shining exception, however, is the board's depth of knowledge about the company. A former CEO (in some cases also the former Chief Financial Officer) has an incredible amount of knowledge about the company, the ability to understand the financial statements in great depth and the will to ask the most important questions about the health of the company. The former CEO is not going to stand aside and let the new CEO destroy what was built during his or her term. In this case, regulation got it wrong and, unfortunately, the proxy advisory firms are exacerbating the problem.

2. Conflict of Interest.

Some proxy advisory firms provide voting recommendations to institutional investors and also provide advice to issuers on how to craft their governance programs. There is an inherent conflict of interest in this process. The relevant proxy advisors insist the conflict is appropriately mitigated. However, no standards, oversight or disclosure obligations apply to these conflicts of interest, which is a serious issue for our members.

3. **Substantial influence without oversight or economic interest.**

   Much of the effort to reform the proxy voting system in Canada and the US over the next several years will go into finding ways to ensure that economic interests and voting rights remain linked. This linkage reduces the possibility that an unscrupulous investor could, for example, use votes to quash a deal so it could benefit on a short sale transaction. The activities of the proxy advisory firms as they are currently conducted are an example of significant influence on the part of a market participant where there is little or no appropriate economic linkage and an absence of oversight. It seems to us inappropriate that the system would continue to allow entities who have significant influence over shareholder decisions to operate without oversight or accountability.

Recommendations

In FDR's 1945 state of the union address, he said, "In a democratic world… power must be linked with responsibility." As our current system continues to provide increasing power to shareholders, it must also provide increasing accountability.
In order to address these concerns, we are recommending improvements in three important areas – oversight, transparency and process.

1. **Oversight.** Regulatory oversight of the key players and influencers in the proxy voting system must be undertaken. Both process and transparency regulations are recommended below.

2. **Processes. –** In order to ensure that shareholders receive balanced and complete information on matters where an issuer disagrees with the validity of a voting recommendation and to ensure that every issuer has the same access to the institutional shareholders as the proxy advisors enjoy, **proxy advisory firms need to be mandated by law to develop, disclose and implement processes in each of the following areas:**

   - **Error prevention.** – Standard procedures that allow **every** issuer company to review the voting recommendations to ensure the accuracy of the underlying data, before the recommendations are published and released to subscribers.

   - **Appeal process.** – Standard procedures that set out the process by which an issuer company can communicate with the proxy advisory firm in a timely manner to appeal a voting recommendation with which the company disagrees.

   - **Error correction.** – Standard procedures that allow correction of information and/or a change in voting recommendation for any specific company to be made in a timely manner and expressly communicated to all of the proxy advisory firm's clients (also in a timely manner).

3. **Transparency.** Transparency to both institutional investors and issuer companies must be improved.

   - **Issuer appeal process.** – Proxy advisory firms need to be **mandated by law** to develop, disclose and implement procedures for the publication **with the proxy advisory firm's voting recommendations** of a response from the issuer to any negative vote recommendation. Alternatively, proxy advisory firms could be treated like others undertaking a proxy contest and be required to prepare, file and mail a circular setting out their views.

   - **Conflict of interest disclosure.** – Regulations need to require proxy advisors to set out the specifics of all actual and potential conflicts of interest. Where the firm has provided consulting services to an issuer, it must be clearly and fully disclosed at the beginning of every voting recommendation summary.

Appreciation

On behalf of our members, we thank the SEC for this opportunity to share our comments on the proxy voting concept release. We look forward to the implementation of appropriate regulations to provide oversight of proxy advisory firms processes and improve their transparency as key influencers in the proxy voting system and North America's corporate landscape.

Contact Information

Please contact Sylvia Groves, Principal of GG Consulting and past Chair of CSCS, at sylvia@grovegovernance.com for additional information or to answer questions about this submission.

Sincerely,

'Lynn Beauregard'

Lynn Beauregard
President