

September 25, 2013

Canadian Securities Administrators Intend to Regulate Proxy Advisory Firms

The Canadian Securities Administrators (CSA), an umbrella organization of Canada's provincial and territorial securities regulators, recently issued an update on their ongoing, consultative process concerning possible regulation of proxy advisory firms. [CAS Notice 25-301, Update on CSA Consultation Paper 25-401, Potential Regulation of Proxy Advisory Firms \(Sept. 19, 2013\)](#). Following feedback from market participants on the impact proxy advisors are having on the integrity of Canadian capital markets, the CSA has concluded that a response from Canadian securities regulators is warranted, with a proposed approach intended to be announced in the first quarter of 2014.

The CSA expects to develop a "policy-based" regulatory approach that would "promote transparency and understanding" and provide guidance on recommended practices and disclosure. While the ultimate scope and nature of the regulatory response will be thoroughly debated, the CSA response is expected to address, at least in some fashion, the following concerns, many of which were raised by the CSA in their [June 2012 consultation paper](#):

- Risks to Canadian capital markets arising from supply and demand market forces failing to provide sufficient "checks and balances" on the quality of proxy advisory voting recommendations due to limited competition in the proxy advisory industry;
- Potential conflicts of interest, such as those arising from proxy advisory firm business models and ownership structures, among other sources of conflict;
- Perceived lack of transparency into voting guidelines, methodologies and analyses;
- Inaccurate reports and limited opportunities for issuers to dialogue with proxy advisors;
- The extent to which proxy advisory firms have become *de facto* corporate governance standard setters, with the effect of compelling issuers to adopt "one-size-fits-all" standards that may be unsuitable for their specific circumstances; and
- Over-reliance by institutional investors on proxy advisory firm recommendations and the potential for proxy advisory firms to significantly influence voting outcomes.

An effective regulatory response by Canadian securities regulators addressing the issues raised by the CSA Consultation would put Canada on a different page than the U.S., where no decision has been made as to whether to subject the proxy advisory firms to additional regulatory oversight. With respect to the U.S., the SEC's wide-ranging July 2010 concept release on the U.S. proxy system also addressed proxy advisory firms, their ability to influence a significant percentage of the vote (despite having no direct economic interest themselves), potential conflicts that these firms may have in formulating their voting recommendations, and concerns about factual inaccuracies in their reports. In July 2013, SEC Commissioner Daniel M. Gallagher [proposed](#) various regulatory reforms to discourage "rote reliance" on the recommendations of proxy advisors, voicing doubts over whether institutional investors properly fulfill their fiduciary duties by relying on and following recommendations from proxy advisory firms.

It remains to be seen if the SEC will follow the Canadian securities regulators' example and subject the proxy advisory firms to additional regulatory scrutiny or whether the SEC will maintain the status quo of minimal regulatory oversight. Regardless of the SEC's decision, institutional investors should be encouraged to exercise their own independent, informed judgments on voting matters and resolve governance and other issues constructively with issuers through direct, case-by-case engagement on the merits.

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