INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

COMMENT PAPER TO THE CANADIAN SECURITIES ADMINISTRATORS

REGARDING PROPOSED AMENDMENTS TO NATIONAL INSTRUMENT 54-101

AND THE SECURITYHOLDER COMMUNICATIONS PROCESS IN CANADA

AUGUST 31, 2010

BACKGROUND

During the course of 2008 and 2009, the IIAC participated in industry working groups organized by the Canadian Securities Administrators (CSA) to discuss important issues affecting securityholder communications and voting in Canada. In particular, members of these working groups, who represented many different stakeholders in the securityholder communications process, discussed National Instrument 54-101 "*Communications with Beneficial Owners of Securities of a Reporting Issuer*" (NI 54-101) and how this rule – and other related securities rules – could be amended to improve the process. The system of "notice-and-access", facilitating electronic access of proxy materials, adopted in the United States, was a subject of considerable review and discussion by the working groups.[1] The IIAC appreciated the opportunity to sit on the CSA's working groups, and looks forward to working with other stakeholders on an ongoing basis to improve the securityholder communication and voting process in Canada.

FUNDAMENTAL PRINCIPLES

The basic principles of beneficial or "street name" ownership (where the ultimate beneficial securityholder owns its shares through an intermediating broker or custodian, with the clearing depository as the registered securityholder) and the distinctions made between Non-Objecting Beneficial Owners (NOBOs) and Objecting Beneficial Owners (OBOs) in NI 54-101 have created a very important role for investment dealers in facilitating the securityholder communications and voting process. This system of ownership has also created distinctions between registered and beneficial securityholders, which affect securityholder communications and voting.

IIAC members have a strong interest in ensuring that the system operates efficiently and reliably for the benefit of their securityholder clients, and in accordance with the requirements of NI 54-101 and other related securities and corporate law requirements. They also have a responsibility to respect the privacy rights of their clients by protecting their personal and trading information.

Our members have identified and ranked the following fundamental principles that should be the driving force behind the securityholder communication and voting process in Canada:

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[1] In July 2010, the Securities and Exchange Commission (SEC) in the United States issued a Concept Release and Request for Comments on the U.S. proxy system (the "Concept Release"). The Concept Release explores a number of issues affecting the efficiency, transparency, accuracy and integrity of the U.S. system. In anticipation of the SEC review, the Securities Industry and Financial Markets Association (SIFMA) released a comprehensive report on the securityholder communications process in the United States, and the IIAC concurs with the principles espoused therein, including its defense of the "street-name holder system". The IIAC will continue to monitor the SEC's review process with a great deal of interest.

1. ***PRIVACY AND RESPONSIBILITY:*** Securityholders should be entitled to choose how their personal information is used and disseminated, and should not be penalized for choosing to protect their personal information. Once made on an informed basis, securityholder choices should be respected and protected, and where any issuer determines to override any such election, that action should be fully and clearly disclosed and explained to the securityholder. Education for all stakeholders about the process, including intensive investor education about obligations and responsibilities, is necessary.

2. ***EQUITY AND RELIABILITY:*** Securityholders, whether registered or beneficial, and whether NOBO or OBO, should have the opportunity to be treated alike and afforded the same opportunity to choose to receive materials and vote. The obligations of each party in the securityholder communication process should be equitable and clearly defined. All parties should carry out these obligations in a reliable and accountable fashion, in accordance with securities and corporate law requirements.

3. ***EFFICIENCY AND FLEXIBILITY:*** Wherever possible, efficiency should be encouraged and enhanced through the use of current electronic technology (including the ability to download materials in easily accessible formats) to increase access to information and decrease waste. Securityholders should be able to determine the format and preferred delivery method of information they would like to receive in order to carry out their responsibilities, and should be able to decline to receive printed information, especially where they rely on their financial advisors to provide information and advice on how to exercise their rights during corporate actions.

These principles are predominantly complementary, but sometimes conflict. Following these principles absolutely will not always be possible because of competing interests and limited resources. However, where there is a conflict between principles, the conflict should be resolved by reference to the most important principle as articulated in the ranking provided above. In a financial environment that is uncertain and facing many new regulatory changes, it will be important to strike a balance between multiple principles and stakeholders, in the interest of improving the proxy process in a fair and equitable manner.

Disenfranchisement of beneficial securityholders: Non-payment by issuers for mailing of materials to OBOs

All beneficial securityholders should be entitled to receive proxy materials and to vote at securityholder meetings. However, this principle must be balanced with the current trend towards consumer privacy. Investors are increasingly aware of privacy issues, and are interested in protecting their personal information and limiting the ability of issuers and their agents to contact them directly. This desire to protect privacy and limit outside solicitation has resulted in an increased number of securityholders opting to be

"Objecting Beneficial Owners" (OBOs). According to Broadridge, 51% of beneficial securityholders are now designated as OBOs, compared with only 38% in 2004.[2] OBOs have not opted out of the securityholder communications and voting process, but have been given the option under NI 54-101 to object to the intermediary disclosing ownership information about the beneficial owner.

Currently, if both the reporting issuer and the securityholder opt not to pay for the mailing, NI 54-101 is silent with respect to which party should pay for the sending of securityholder materials to OBOs who have opted to receive the materials. The rule leaves considerable doubt as to how the situation should be handled, and the ultimate result is that these OBOs may not receive mailings to which they are entitled.

Securityholders, whether registered or beneficial, should have the opportunity to be treated alike. NI 54-101 must endeavour to treat NOBOs and OBOs similarly regarding securityholder communications and must explicitly set out that payment for OBO mailings is the responsibility of the reporting issuer who wishes to communicate with its investors.

Section 2.14 of NI 54-101 states that the reporting issuer must pay for mailings that are sent to OBOs who have declined to receive materials, allowing reporting issuers to send (and pay for) unwanted mailings to securityholders who have asked not to receive them; however OBOs who want to receive materials can be disenfranchised by an issuer who chooses not to pay for the mailing. This is a strange and inequitable result, and it makes little sense for the rule to be silent in this regard, when in all other instances, the reporting issuer pays for the mailing. Intermediaries must not be effectively pushed to pay for these mailings. Issuers must be responsible in the same way as if they override a securityholder election to not receive materials. Otherwise, OBOs are effectively penalized for wanting to protect their privacy and limit solicitation.

The proposed amendments to NI 54-101 do not address this issue in a satisfactory manner. In fact, the Request for Comments makes it clear that reporting issuers continue to have the option to refuse to pay for delivery of proxy-related materials to OBOs. Instead, it is proposed that where the issuer refuses to pay, this fact must be disclosed in the management information circular. Oddly, this circular is also required to disclose "that it is the OBO's responsibility to contact the OBO's intermediary to make any necessary arrangements to exercise voting rights attached to the OBO's securities". It is unclear how a securityholder who has not been sent proxy-related materials (as a result of non-payment by both issuer and securityholder) will be able to find this disclosure statement. The proposed disclosure requirement is not a viable solution to what has become an issue of disenfranchisement for securityholders and added costs for intermediaries.

[2] Statistics provided by Broadridge Investor Communications Solutions, Canada, 2010.

Furthermore, the proposed changes to Subsection 3.4.1(3) of the Companion Policy states that "if a reporting issuer has chosen not to pay for proximate intermediaries to deliver proxy-related materials to OBOs, it must still provide to the proximate intermediary the number of sets of proxy-related materials that the proximate intermediary requested for forwarding". This requirement, while it may have been intended to ensure that reporting issuers actually send requested materials to intermediaries, may have the unintended effect of completely eliminating the incentive for issuers to pay for delivery to OBOs, instead relying on the intermediaries to pay to forward materials in every single instance. Issuers must not be able to choose not to pay, knowing that intermediaries looking out for the best interests of their securityholder clients will likely take on the responsibility, and the added costs.

This emerging scenario has been proven by the statistics: As at the end of June 2010, 37% of issuers were not paying for delivery of proxy-related materials to OBOs. Intermediaries took the initiative and paid for mailings to 68% of this group, even though they are not obligated to do so under NI 54-101. However, the remaining 32% received no mailings and were effectively shut out of the beneficial communication process. [3] These numbers have increased since 2009.

It is often presumed that intermediaries should, or are able, to pass these costs onto the securityholders. However, most investment dealers have indicated that they are unable to pass along these costs for a variety of reasons. Dealers are reluctant to charge small mailing fees to individual clients (even if these small amounts add up to large amounts in the aggregate) because they do not want to be perceived as "nickel and diming" clients in a highly competitive environment. Dealers are also under a great deal of pressure to provide clients with high rates of return on investments, and have been facing recent criticism from government and regulators on the fees that they charge their clients. And perhaps most importantly, OBOs should not be penalized for protecting their privacy by being charged delivery fees that registered owners or NOBOs are not charged. In the face of conflicting requirements, most dealers have little choice but to absorb these charges – but these costs are growing. Small, independent dealers cannot afford to absorb more costs at a time when they are also dealing with depressed markets and increased regulatory costs.

The costs of mailing securityholder communications materials must be for the account of the reporting issuer and at no time should intermediaries or securityholders be effectively required to bear these costs when reporting issuers decline.

The CSA has said that one of the fundamental principles of NI 54-101 is to "equitably and clearly define the obligations of each party in the securityholder communication process"; the first step in this process is to recognize that issuers should view the cost of communicating with all of their securityholders as a basic cost of doing business as a public company. Intermediaries facilitate this process, but should not be responsible for

[3] Broadridge, 2010 (see note 2).

the costs of the issuers to carry out their corporate duties; likewise, securityholders should not be penalized for choosing to protect their personal information. The implementation of new technologies, including notice-and-access, should greatly offset the costs of these communications, so it seems reasonable to ensure that all securityholders who want materials should receive them.

Reducing costs and waste through notice-and-access

The implementation of notice-and-access will ultimately reduce waste, lower costs, and make the system more efficient. The success of the implementation will depend heavily upon the ease with which securityholders can access the materials. Securityholders should be able to access materials using one link, and should be able to seamlessly transition to online voting websites where issuers have chosen this option. Otherwise, there is a substantial risk of securityholder frustration and confusion, leading to disinterest and low voter turnout. The proposed amendments provide a solid foundation to move toward this goal, however, there are changes that should be made to increase the successful acceptance of notice-and-access in Canada, by both reporting issuers and securityholders.

Clarification of proposed subsection 2.12(3)

Proposed subsection 2.12(3) states that a reporting issuer that sends proxy-related materials indirectly to a beneficial owner using notice-and-access must "*provide the information…to the intermediary in sufficient time for the intermediary to send a document containing that information to the beneficial owner*" before the meeting. This language could be interpreted to mean that intermediaries are responsible for producing the required Notice, instead of reporting issuers – an interpretation that would result in a complete reversal of the current communication process.

The language in proposed subsection 2.12(3) should be amended to match the language in proposed subsection 2.12(1) – clarifying that reporting issuers that send materials using notice-and-access must provide the ***materials*** *to the intermediary in sufficient time for the intermediary to* ***forward the materials*** *to the beneficial owner.*

Expand notice-and-access to include special meetings

The CSA's concern about monitoring the implementation of notice-and-access before extending it to special meetings where fundamental changes are being voted on is well understood, but there is also a corresponding concern that limiting the implementation will only serve to confuse securityholders, who will receive different types of mailings for different meetings. There is also a concern that the large number of special meetings will limit reporting issuers who would like to take advantage of the opportunity to use notice-and-access. Broadridge has provided recent data showing that 61.7% of meetings

over the past year were identified as "Annual and Special Meetings", and thus not eligible for notice-and-access.[4]

The use of notice-and-access should be expanded to all meetings, including special meetings, at the option of the issuer.

The proposed amendments already provide reporting issuers with the ability to opt into the notice-and-access process, giving them the choice to mail paper copies of proxy materials. Because of this opt-in process, it seems unnecessary to exclude any types of meetings from notice-and-access.

Limiting the use of stratified mailings

In order to reduce costs and waste, notice-and-access should ultimately become the default option for securityholder communications. As mentioned above, there is a concern that sending communications in a mixture of formats (especially when they have not been chosen by the securityholder) will cause confusion, and goes against the basic principle that securityholders should have the opportunity to be treated alike.

The issuers' choice to send different types of mailings to different strata of securityholders (e.g. by percentage of holdings) should be limited to specifically enumerated circumstances.

For example, as described fully below, if issuers continue to be given the option of mailing full paper sets of proxy materials to securityholders (especially those who have declined to receive them), it would be preferable if securityholders who have opted out of receiving materials altogether are sent a notice-and-access package instead of the full proxy materials.

Unwanted mailings to beneficial securityholders

The proposed amendments to NI 54-101 do not address the concerns of IIAC members, who continue to receive feedback from frustrated clients who receive unwanted mailings. Clear directions by a beneficial securityholder on Form 54-101F1 to decline all materials – including a Notice under a new system of notice-and-access – should be respected and should not be overridden by a reporting issuer as currently allowed in NI 54-101. Our members' clients have made it clear through their feedback that the receipt of any materials is seen as an indication that the industry and its regulators are not listening to their choices and concerns. This is the primary reason why the IIAC has advocated that

[4] Broadridge, 2010 (see note 2). Data was provided on selection of Meeting Type for meetings held between July 1, 2009 and June 30, 2010.

the ability for the issuer to mail to securityholders who have declined to receive materials be removed from NI 54-101 (ss. 2.10 and 4.3).

Issuers should not be able to override the securityholders' choices not to receive mailings.

While the IIAC also recognizes the concerns expressed by the CSA and by other stakeholders that beneficial securityholders be alerted to the existence of meetings, especially special meetings dealing with fundamental changes, we question whether the printing and mailing of packages to securityholders who have declined to receive materials is effective. Low voter turnout may be further exasperated by the securityholders' frustration at having received paper materials against their explicit instructions. We believe that an overall balance can be struck through the use of notice-and-access or stratified mailings for those securityholders that have declined to receive materials. The CSA should consider the use of these waste-reducing mechanisms to minimize the frustration and confusion for the securityholder, and to reduce costs for reporting issuers.

Use notice-and-access or limited stratified mailings to reduce waste

If the CSA is of the opinion that issuers should retain the ability to override the choice of the beneficial securityholder to decline mailings, the implementation of notice-and-access will reduce the cost and waste of printing and mailing full sets of securityholder materials. Securityholders have identified the reduction of waste and environmental concerns as reasons why they do not want to receive the full package of proxy materials. Mailing a one-page Notice to these securityholders with specified language rather than sending the full package of materials, along with adequate disclosure outlining why the securityholder has received the Notice, may provide a "middle ground" solution.

If issuers retain the ability to override the choice of the securityholder to decline materials, the CSA should consider the option of requiring issuers who choose to mail to securityholders against instructions to send only a Notice, even where the issuer has chosen to mail a full set of materials to the rest of the securityholders who have elected to receive mailings.

Implementing this variation on a "stratified mailing" would ensure that all securityholders are made aware of a meeting and how to access materials, while reducing the amount of materials received by those securityholders who do not want to receive the mailings.

Dealing efficiently with beneficial securityholders who request paper materials/proxies

The IIAC was pleased to see that the proposed notice-and-access system includes a mechanism that allows securityholders to receive paper materials upon request. However, there is a concern about requests for paper copies of proxy materials close to the date of the meeting. Three business days seems like a reasonable amount of time for paper copies to be delivered, however, there is no guidance provided as to how last minute requests for paper materials should be handled. It may be helpful to require language in the Notice indicating that requests for paper copies made within three business days of the meeting date are unlikely to be filled in time for the meeting.

Prescribed Notice and limit on additional materials

In order to maintain consistency between proxy materials, and to minimize securityholder confusion, a prescribed Notice should be provided in NI 54-101. This should provide the CSA with comfort that will facilitate opening up the notice-and-access process for all meetings, including special meetings.

A prescribed Notice should be provided in NI 54-101, and additional materials that are not educational materials about the notice-and-access process should not be included.

It will be very important during the implementation phase for additional materials that explain the notice-and-access process (such as a Q&A) to be included with the Notice and VIF. However, it will not be appropriate to include other materials that address the substance of the matters to be voted on at the meeting. This will cause confusion for securityholders, create a disincentive for investors to read the full information circular, and ultimately undermine the purpose of reducing the amount of materials that is the driving force behind the notice-and-access process.

Use of NOBO lists

As mentioned previously, investors are increasingly concerned about protection of their personal information and potential unwanted solicitation, and are opting for OBO status in increasingly high numbers, accounting for more than half of all beneficial securityholders as of June 2010. However, there are also privacy concerns about the use of personal information of Non-Objecting Beneficial Owners (NOBOs).

The IIAC was pleased to see that the proposed amendments to NI 54-101 provide stricter rules on the use of NOBO lists by third parties, and the matters for which the indirect sending procedures may be used. Limiting the instances in which non-reporting issuers can gain access to securityholder information, and communicating this change to securityholders may be an important incentive for them to choose to be NOBOs,

increasing the transparency and reducing complexity in the securityholder communication process.

Opportunities for Education

The introduction of the notice-and-access model in Canada is also an important opportunity for the CSA and interested parties in the securityholder communication process to educate investors and reporting issuers on the broad implications of NOBO and OBO elections and how they affect the corporate governance process. Education is an critical step in helping issuers to understand the importance of treating all securityholders equitably – reporting issuers may not be aware that by choosing not to mail to OBOs that they may be effectively disenfranchising half of their securityholders. This may require some changes to forms promulgated under NI 54-101, but should more likely take the form of a proactive educational effort aimed at reporting issuers and coordinated by the CSA, leveraging the expertise of various constituencies represented at the CSA industry working groups.

During the implementation phase, securityholders should also be receiving educational materials (such as a Q&A) about the notice-and-access process. Stakeholders in the process should be involved in developing these materials; however, securityholder education should ultimately be coordinated and approved by the CSA to ensure that materials accurately reflect regulatory requirements and are distributed on a national level.

CONCLUSION

The introduction of notice-and-access is a positive step toward improving the securityholder communications process in Canada. However, there are a number of other changes outlined in this paper, and which have been discussed at length in prior meetings but which are not addressed at all in the CSA proposals, which will enhance the process in accordance with the identified fundamental principles. The IIAC and its members look forward to playing a role in these efforts.