



Via Electronic Mail

February 24, 2014

Paul Halucha
Director General
Marketplace Framework Policy Branch
Industry Canada
235 Queen Street, 10th Floor
Ottawa, Ontario
K1A 0H5

CC: cbca-consultations-lcsa@ic.gc.ca

Re: *Consultation on the Canada Business Corporations Act*

Dear Mr. Halucha:

I am writing on behalf of the Council of Institutional Investors (Council), a non-profit association of pension funds, other employee benefit funds, endowments and foundations with combined assets that exceed \$3 trillion. The Council is the leading voice for effective corporate governance and strong shareowner rights in the United States.¹ The Council has long held that sound corporate governance policies are in the long-term interests of shareowners, and believes that the international market as a whole benefits when regulations provide adequate protections for stakeholders.

The Council appreciates the opportunity to comment on Industry Canada's public Consultation (Consultation) on the Canada Business Corporation Act (CBCA).² We commend Industry Canada for continuing to pursue a national corporate governance framework that encourages fair business practices, supports investment, and instills investor confidence in the marketplace. Our comments respond to eight of the subject areas raised in the Consultation, and they are informed by the Council's membership approved corporate government policies.³

Executive Compensation

The Council's membership approved corporate governance policies state that without exception, all companies should provide advisory shareowner votes on the compensation of senior executives on an annual basis.⁴

¹For more information about the Council of Institutional Investors ("CII"), please visit CII's website at <http://www.cii.org>.

²Consultation on the Canada Business Corporations Act, Industry Canada, available at http://www.ic.gc.ca/eic/site/cilp-pdci.nsf/eng/h_cl00867.html.

³The entirety of the Council's Membership Approved Corporate Governance Policies can be found at http://www.cii.org/corp_gov_policies.

⁴Corporate Governance Policy 5.2 entitled, Advisory Shareowner Votes on Executive Pay.

Council policy also states that a corporation's compensation philosophy should be clearly disclosed to shareowners in annual proxy statements, and it is the responsibility of the compensation committee to ensure that every aspect of compensation for all executives, directors, and other management positions are clearly, comprehensively, and promptly disclosed in plain English via the annual proxy statement.⁵ Such aspects of compensation include salary totals, short and long-term incentive compensation, how executive salaries fit within the overall pay structure of the company, and any other forms of compensation.⁶ Additionally, the compensation committee should provide full descriptions of the qualitative and quantitative performance measures and benchmarks used to determine compensation, including the weightings and rationale for each measure.

The Council believes that executive compensation oversight is a critical aspect of a company's governance, and ought to be public information. Pay decisions are one of the most direct ways for shareowners to assess the performance of the board, and it is shareowners, not executives, whose money is at risk. Executive pay has a bottom line effect, not just in terms of dollar amounts, but also by formalizing performance goals for employees, signaling the market, and affecting employee morale.⁷

Annual Elections

Council policy states that all directors should be elected annually, and that director elections should not occur on a classified, or staggered, basis.⁸ The Council generally concurs with those academic studies indicating that staggered boards and long terms of office impede the ability of long-term shareowners to make necessary changes to the composition of the board, and effectively provide directors with an opportunity to entrench themselves without threat of removal.⁹

Majority Voting

The Council is encouraged that the Toronto Stock Exchange recently added a majority voting requirement to its listing standards.¹⁰ The benefits of majority voting would be magnified if the CBCA were to enshrine the policy into legislation.

Council policy supports a majority voting standard for uncontested director elections. We believe that any director who does not receive the majority of votes cast should leave the board as soon as practicable, and not be reappointed. During contested director elections, plurality voting should apply. An election is contested when there are more director candidates than there are available board seats.¹¹

⁵Corporate Governance Policy 5.5b *entitled*, Executive Pay Philosophy.

⁶Corporate Governance Policy 5.5h *entitled*, Disclosure Practices.

⁷Corporate Governance Policy 5.1 *entitled*, Executive Compensation Introduction.

⁸Corporate Governance Policy 2.1 *entitled*, Annual Election of Directors.

⁹Coates, Bebchuk, and Subramaniam, The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=304388.

¹⁰Toronto Stock Exchange Amendment on Majority Voting Requirement, *available at* http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=867.

¹¹Corporate Governance Policy 2.2 *entitled*, Director Elections.

Our policy is based on the widely accepted view by participants in most developed markets¹² that majority voting ensures that directors are held accountable to shareowners, considering that a plurality voting standard enables directors to be elected or reelected even if ninety percent or more the shareholders vote against a director.¹³ As the Investors' Working Group observed in their seminal report on U.S. financial regulatory reform, "plurality voting in uncontested elections results in 'rubber stamp' elections."¹⁴ Rubber stamp elections pose no genuine threat of removal, and thus votes cast under the plurality voting system are unlikely to shape director behavior in favor of long-term shareowners.

The Consultation expresses concern over the possibility of a failed election, in which no director gains a majority vote. However, recent history suggests that the likelihood of a full board failing to win majority support is highly remote. In 2013, only 13 companies in the Russell 3000 index witnessed elections in which more than one director failed to receive majority support in an uncontested election. Not a single one of these companies saw more than four directors fall short of the majority threshold.¹⁵ Furthermore, we believe the Toronto Stock Exchange's recently adopted majority voting amendment effectively addresses the concern by providing that a board has the discretion to reject failed director resignations in the face of exceptional circumstances.¹⁶

Electronic Meetings

For over a decade, the CBCA has allowed corporations to post important shareholder documents electronically, as well as host virtual meetings. Council policy states that companies incorporating virtual technology into their shareowner meeting should use it as a tool for broadening, not limiting, shareowner meeting participation and dispersal of shareholder documents. With this objective in mind, a virtual option should facilitate the opportunity for remote attendees to participate in the meeting to the same degree as in-person attendees, but only as a supplement to traditional in-person shareowner meetings, rather than as a substitute.¹⁷

Proxy Access

Council Policy states that significant long-term investors and investor groups should have access to management proxy materials for the purposes of nominating directors to the board.¹⁸ Eligible investors must have owned company stock for at least two years and own in aggregate at least three percent of a company's voting stock. Company proxy materials and related mailings should provide equal space and equal treatment of nominations by qualified investors.

¹²Lisa M. Fairfax, "Shareholder Democracy" 85 (Carolina Academic Press 2011) (on file with Council).

¹³Investors Working Group, "U.S. Financial Regulatory Reform: The Investors' Perspective" 22 (July 2009), available at http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

¹⁴*Id.*

¹⁵ISS Database of Director Election Results (2013) (on file with Council).

¹⁶Toronto Stock Exchange Amendment on Majority Voting Requirement, available at http://tmx.complinet.com/en/display/display.html?rbid=2072&element_id=867.

¹⁷Corporate Governance Policy 4.7 *entitled*, Electronic Meetings.

¹⁸Corporate Governance Policy 3.2 *entitled*, Access to the Proxy.

We believe that a five percent ownership requirement for proxy access places an unrealistically high hurdle on groups of shareowners who wish to make a nomination. The institutional investors most likely to make use of proxy access, largely public and union pension funds, hold a relatively small interest in most public companies due to their passive management strategies and highly diversified portfolios, thus making a proxy access provision built on a five percent threshold nearly inconsequential.¹⁹ The board of directors serves as the representatives of shareowners, and thus shareowners should have the right to nominate their own representatives. Offering proxy access to a broader class of long-term shareowners would invigorate board elections, make boards more responsive to shareowners, and improve board vigilance in their oversight.

Split Role of CEO and Chairman

Council policy states that the CEO and chair roles should only be combined in very limited circumstances. In such circumstances, the board should provide a written statement in the proxy materials discussing why the combined role is in the best interests of shareowners, and it should name a lead independent director who has approval over information flow to the board, meeting agendas, and meeting schedules. This ensures a structure that provides an appropriate balance between the powers of the CEO and those of the independent directors.²⁰

The Council believes that an independent chair supports a board of directors in carrying out its primary duty—to monitor the management of the company on behalf of its shareowners. A CEO who also serves as chair can exert a dominant influence on the board and its agenda, weakening the board's oversight of management. Separating the chair and CEO positions avoids this fundamental conflict of interest. An independent board chair provides a better balance of power between the CEO and the board and supports strong, independent board leadership and functioning.²¹

Conflict Resolution

The Council does not oppose the expansion of options for conflict resolution available to shareholders, including arbitration. However, Council policy states that companies should not attempt to restrict the venue for shareowner claims by adopting charter or bylaw provisions that seek to establish an exclusive forum. Neither should companies attempt to bar shareowners from the courts through the introduction of forced arbitration clauses.²² Forced arbitration provisions represent a potential threat to the principles of sound corporate governance, as shareholders may no longer be able to hold managers accountable to legal standards against negligence, may be limited in recovering appropriate remedies, and may not benefit from public scrutiny in such cases.

¹⁹ Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Nancy M. Morris, Secretary, Securities and Exchange Commission, *available at* <http://www.sec.gov/comments/s7-16-07/s71607-200.pdf>.

²⁰ Corporate Governance Policy 2.4 *entitled*, Independent Chair/Lead Director.

²¹ Council Issues and Advocacy Briefing; Independent Board Chair, *available at* http://www.cii.org/independent_boardchair.

²² Corporate Governance Policy 1.9 *entitled*, Judicial Forum.

Independent Auditors

Council policy provides a detailed description of the role that independent auditors play in combatting bribery and corruption. The policy states that a corporation's audit committee must hire, compensate, oversee, and above all, take proactive steps to promote auditor independence and audit quality.²³ If necessary, the audit committee should terminate the company's independent auditor after considering a number of relevant factors.²⁴ Even in the absence of egregious reasons, the audit committee should consider periodically changing the auditor, bearing in mind the auditor's tenure, director relationships with the auditor, the quality and frequency of communication from the auditor, and the level of transparency of the audit firm, among other reasons.

The audit committee should publicly provide to shareowners a plain-English explanation of the reasons for a change in the company's external auditors.²⁵ If the audit committee chooses to retain an auditor with more than ten consecutive years of service, or if the auditor is retained despite knowledge of substantive deficiencies, the committee report should include a fact-specific explanation for not changing the auditor.²⁶

Council policies concerning independent auditors are guided by the belief that shareholders are the ultimate benefactors of an auditor's work product, and shareholders' confidence in the integrity of a company's reporting system enable them to invest their money with some confidence in the accuracy of the company's public information.

Diversity of Corporate Boards

Council policy states that a diverse board offers benefits that enhance corporate financial performance, particularly in today's global market place. As such, it is a best practice for corporations to maintain diverse boards by including such considerations as background, experience, age, race, gender, ethnicity, and culture in any nomination instructions on corporate charters and bylaws.²⁷

Many studies indicate that Board diversity offers corporations access to a broader pool of knowledge, experience, skills, and likely real economic value added. Companies with diverse boards were shown to perform better than boards without diversity, and those companies with a high ratio of diverse board seats exceeded the average returns of the Dow Jones and NASDAQ indices over a five-year period.²⁸

²³Corporate Governance Policy 2.13a *entitled*, Audit Committee Responsibilities Regarding Independent Auditors.

²⁴*Id.*

²⁵Corporate Governance Policy 2.13g *entitled*, Disclosure of Reasons Behind Auditor Changes.

²⁶*Id.*

²⁷Corporate Governance Policy 2.8b *entitled*, Board Diversity.

²⁸Deborah L. Rhode and Amanda K. Packel, Diversity on Corporate Boards, Stanford Center on the Legal Profession, Submitted for "Diversity on Corporate Boards: When Difference Makes a Difference" (Sept. 10, 2009).

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Thank you for considering our comments to the Consultation. We hope that the Council's input will help create a more efficient and competitive governance framework for not only the 235,000 Canadian business that are federally incorporated under the CBCA, but also for the various markets across the globe that look to Canada's leadership in the corporate governance arena. If you have any questions regarding our comments, please contact me at 202-261-7088 or jordan@cii.org, or our general counsel Jeff Mahoney at 202-261-7081 or jeff@cii.org.

Sincerely,

A handwritten signature in blue ink that reads "Jordan Lofaro". The signature is written in a cursive, flowing style.

Jordan Lofaro