

## **Shareholder Democracy and Proxy Voting in Canada**

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The focus on all aspects of corporate governance has been steadily increasing.

The initial focus was on the role of directors in ensuring that the business of the corporation is managed to maximize value for shareholders. As enterprises failed earlier in the decade as a result of mismanagement, the focus increased sharply, and the burden of regulation and expectations related to best corporate governance practices increased proportionately.

It is the natural course of that progression to focus on the role of the shareholder in selecting, electing, evaluating and eventually replacing the directors.

A number of important initiatives along those lines are gaining traction in all jurisdictions. Say-on-pay and majority voting are two of the most important of those initiatives. Institutional shareholders and their advisors are paying much more attention to how they vote their shares in director elections.

This is good because it has real potential to motivate directors to pay closer attention to their role, and to how their decisions are perceived and evaluated by shareholders. Social pressure resulting from votes withheld from directors, particularly where the directors' re-election might be in doubt, is strong medicine indeed.

The amalgam of these measures is what is generally referred to as "shareholder democracy".

For a democracy to function well, the people must be able to vote. This begs the question whether shareholders have the right to vote. The answer at first blush for holders of common shares is self-evident: of course shareholders have the right to vote.

The real nub of truth for director elections is much more nuanced and quite a bit more problematic to arrive at however.

First off, not all shareholders have the right to vote. Some shares may not have voting rights. But even for typical common shares that do have voting rights, not all holders of those shares are treated equally. Only registered shareholders are contemplated as having the full exercise of the rights that are attached to the shares they hold. Shareholders whose name is not entered on the register of shares are not shareholders within the meaning of most corporation laws, and those holders have no standing to vote.

This is increasingly problematic since most shareholders are not registered holders. Their shares are held on their behalf by others. In the first case, the actual registered shareholder is the depository. In the US it's the Depository Trust Company, in Canada it's the Canadian Depository for Securities. The depositories hold the shares on behalf of brokers and other intermediaries. As often happens, there can be a maze of intermediaries between the holder and the registered share position. Holders whose shares are held this way are "beneficial shareholders".

The financial rights attached to shares are well administered in the current system. This means that registered and beneficial shareholders alike receive the dividends and proceeds of transactions to which they are entitled quickly and reliably.

It is not necessarily so with the right to vote. Whereas the incentives of all market participants are clear and well-aligned with respect to financial rights, voting rights haven't benefitted from the same focus. The incentives are sometimes not as well perceived or appreciated, with the result that the alignment among participants that would be required to allow votes to be delivered and counted as easily and efficiently as dividends is lacking.

The result is that the shareholder voting system is in large measure dysfunctional.

That dysfunction is some way or other sometimes results in the effective disenfranchisement of beneficial shareholders. The impact is not merely felt by small retail shareholders as one might expect. Large institutional shareholders fall victim to the dysfunction as well.

The problems are exacerbated by the complexity of the capital markets, with the practices of share lending and short selling compounding the difficulty of determining who is truly entitled to cast the votes associated with a given share. Because many shareholders simply do not vote, it can be difficult to determine instances of over-voting, which is where more than one holder votes the same share.

There is a growing acknowledgement in the US and Canada that the processes of shareholder democracy need attention, particularly since both regulators and institutional shareholders are placing substantial wagers on shareholder votes as an incentive for better and more robust corporate governance.

Those that have sought to map the processes by which shares are voted have drawn flow charts of daunting complexity. A symptom of that complexity is that each of the stakeholders in the voting process only sees the narrow slice of the overall voting pie that is closest to them. This is true of shareholders, issuers, transfer agents, proxy agents, intermediaries, depositories, custodians, proxy solicitors, brokers, regulators, and governance professionals.

Each stakeholder has a vested interest in the way the current processes work. In some ways they perceive themselves to be invested in the dysfunction. In some cases this may be true. In other cases the complexity of the system makes it difficult for a given stakeholder to perceive where their best interests truly lie, and they may be reluctant to consider change that they might otherwise embrace if they had a better understanding of the whole pie.

The Canadian Society of Corporate Secretaries represents one of those stakeholders: corporate secretaries and governance professionals. In many ways we are the professionals closest to the front lines.

CSCS believes that a necessary first step in transforming the processes of shareholder democracy to make them suitably efficient and reliable, is for all stakeholders to gain a better understanding of the whole pie. The multiplicity of parties and the very different worlds in which they operate have to date impeded gathering and sharing the information that is vital to that understanding

The Canadian Society of Corporate Secretaries has decided to become the catalyst for that vital first step.

CSCS is hosting an unprecedented gathering of the key stakeholders in the Canadian capital markets on October 24 and 25, 2011 in Toronto. The two-day summit conference will assemble all stakeholders in

moderated expert panels. Participants will be strongly encouraged to submit papers to the Summit that set out the processes that they administer along with an evaluation of current outcomes, the strengths and weaknesses of the processes, and the opportunities for improvements they feel exist.

As part of the Summit, there will be expert panels focusing on the proxy voting processes in other markets including the US, Europe, and Asia.

At the conclusion of the Summit, CSCS hopes to have created an unparalleled repository of information that can serve as a basis for understanding how the current system works, identifying the points of failure, and proposing changes that serve to level the playing field for all shareholders, registered and beneficial alike. We will be working with noted academics from prominent Canadian universities to ensure that the documentation from the Summit, including video and transcripts of the sessions are assembled as a cohesive work to facilitate subsequent reference.

Information concerning the Summit, including the preliminary program, registration and sponsorship is available on CSCS' website at [www.cscs.org](http://www.cscs.org).

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