

Conclusion of the Opening Act: Proxy Access Becomes Reality in Canada

Two Banks Have Adopted “5/3/20/20” Model and Want Bank Regulators to Endorse “3/3/20/20”¹

The curtains have been drawn on the first act of proxy access in Canada. This past spring, The Toronto-Dominion Bank (“TD”) and the Royal Bank of Canada (“RBC”) each received a shareholder proposal pushing for proxy access, ultimately supported by 52.2% and 46.83% of shareholders, respectively. This past week, both banks, acting in lockstep, published updates via their websites to adopt a virtually identical Proxy Access Policy (the “Policy”). A joint submission was also made to the Government of Canada’s Department of Finance, advocating for certain amendments to the Bank Act to permit the share ownership threshold in the Policy to be reduced to 3% from 5% such that the Policy will conform to the “3/3/20/20” market standard in the U.S. but slightly different from what shareholder Mr. Lowell Weir requested in his proposal and what Canadian Coalition for Good Governance (“CCGG”) has stood for (see detailed comparison in the table below).

Comparison of TD and RBC’s Policy with the Original Shareholder Proposal and CCGG

Proposed by Lowell Weir 3/3/-/25	CCGG-Endorsed Policy 3(5)/-/-/20	TD and RBC Policy 5(3)/3/20/20
<ul style="list-style-type: none"> A single shareholder or a group holding 3% continuously for three years shall have the right to nominate directors not exceeding 25% of the board No defined limit on group The nomination shall be accompanied with a 500-word statement for each nominee and inclusion of shareholder nominees on the proxy card and information such as the name of the shareholder nominees in the proxy circular Where there are competing shareholder nominations, the shareholder proposal asks that the board shall adopt procedures for promptly resolving disputes including the priority to be given to multiple nominations exceeding the 25% limit 	<ul style="list-style-type: none"> Stratified share ownership levels (5% ownership for a company with a market capitalization of less than \$1 billion, and 3% for a company with a market capitalization of \$1 billion or more) No defined limit on group No holding period requirement Right to nominate lesser of three directors or 20% of the board No limit to nominator’s statement Where there are competing shareholder nominations, each eligible shareholder will select one nominee until the maximum permitted, in order of largest to smallest shareholder 	<ul style="list-style-type: none"> A single shareholder or group holding 5% continuously for three years shall have the right to nominate the greater of two directors or 20% of the board Shareholder group maximum of 20 The minimum threshold required by the Bank Act (Canada) to submit nominations for inclusion in the proxy circular is 5% TD and RBC have written to the Department of Finance advocating amendments to the Bank Act which will permit the share ownership threshold to be reduced to 3% The nomination shall be accompanied with a 500-word statement Procedures to deal with competing shareholder nominations

Key Divergence of TD and RBC Policy with Shareholder Proposal and CCGG:

- The Policy uses 5% threshold which is permitted by the Bank Act, as opposed to 3% as per the shareholder proposal; however, the banks have proposed legislative amendments to the Bank Act to permit a 3% threshold
- The Policy requires continuous ownership for three years, contrary to the CCGG’s published position in its May 2015 policy paper that does not have a holding period requirement, which position is under review
- The Policy affords the right to nominate the greater of two directors or 20% of the board, as opposed to 25% as per the shareholder proposal (generally, two or three directors and 20-25% is an acceptable market standard in the U.S.)

¹ We use a commonly acceptable 4-number system to describe different proxy access models: (1) shareholder ownership threshold, 3% or 5%; (2) holding period requirement, 3 years or none; (3) group limit, 20 or unlimited; (4) maximum number of proxy access nominees, 20% or 25%.

In the joint submission, the banks also seek changes to the Bank Act to exclude “empty voting” situations from counting as shares owned for the purpose of proxy access nominations.

Proxy Advisor Views

Given the recent developments, we anticipate that proxy advisors Institutional Shareholder Services Inc. (“ISS”) and Glass, Lewis & Co., LLC (“Glass Lewis”) will develop more fulsome and formal policies relating to proxy access for its Canadian benchmark guidelines. While both ISS and Glass Lewis have developed guidelines as it pertains to proxy access for the U.S. market, given the nuances in Canadian corporate law, we anticipate that proxy advisors will take into account the “extensive [and on-going] consultations with its shareholders on proxy access, both before and after its shareholder meeting” by both TD and RBC to arrive at the current “5(3)/3/20/20” version.

Proxy Advisor Policy Overview

In the U.S., ISS generally recommends in favour of shareholder or management proxy access proposals satisfying all of the following:

- **Ownership threshold:** Maximum requirement not more than 3% of the voting power;
- **Ownership duration:** Maximum requirement not longer than three years of continuous ownership for each member of the nominating group;
- **Aggregation:** Minimal or no limits on the number of shareholders permitted to form a nominating group;
- **Cap:** Cap on nominees of generally 25% of the board.

Where proxy access is adopted in response to a majority-supported shareholder proposal, ISS may recommend that shareholders withhold votes from the Nominating and/or Governance Committee members or the entire board if the proxy access provisions are materially more stringent. While the version proposed by the banks generally conforms with ISS’ guidelines for primary proxy access features, TD and RBC cap nominees at 20% of the board as opposed to 25%. We believe 20% to 25% ownership is consistent with general market practice and may not be a topic of concern in and of itself for the proxy advisors.

Beyond the Primary Features

The Policy sets the stage for the primary features of proxy access with the “3/3/20/20” model being the gold standard contender. The focus in the U.S. has now shifted to the finer points of proxy access (i.e. proxy access 2.0) and the identification of add-on provisions that restrict the right of proxy access. In Canada, we expect that market participants will likely skip the primary features discussion and fast-forward to scrutinizing the nuances of the restrictive provisions.

From a proxy advisor perspective, ISS views two particular provisions to be especially problematic in that they effectively nullify the proxy access right:

- Counting different mutual funds under common management as separate shareholders for purposes of an “aggregation limit” on the number of shareholders who can pool their holdings to reach the 3% threshold;

- Requiring nominating shareholders to pledge to continue to hold their shares past the date of the meeting at which an access candidate is successfully elected to the board.

Both TD and RBC have expressly outlined that mutual funds under common management are counted as one shareholder per the aggregation limit and nominating shareholders are only required to hold their shares through the date of the meeting rather than after. It is clear that both TD and RBC have considered the detailed provisions when drafting the Policy.

However, other provisions within the TD and RBC Policy may be debated in the months to come:

- Both banks require the nominating shareholder or its proxy holder to attend the shareholder meeting to present the nomination, otherwise the nominees will be omitted from the vote. In recent guidance published by the Toronto Stock Exchange (“TSX”) in March 2017, the TSX found a similar provision contained within advance notice provisions to not be consistent with the policy objectives of Director Election Requirements of the TSX Company Manual. We are aware that ISS will generally recommend that shareholders vote AGAINST advance notice provisions should such provisions that are counter to the TSX’s guidance be contained within said policies. It remains to be seen how the TSX, shareholders, and proxy advisors will view these inconsistencies across different mechanisms for director nominations.
- Unlike the U.S. where nominating shareholders may use the standard Schedule 14N for proxy access nominations, nominating shareholders in Canada must use the agreement form as attached and drafted by the banks within the Policy. Within this form, Section 6(d) highlights that each party submits to the exclusive jurisdiction of any Ontario courts sitting in Toronto for litigation purposes arising out of the agreement. In effect, nominating shareholders are forced to submit to the exclusive venue of Ontario, albeit only for the purpose of the proxy access nominations agreement. Shareholders and proxy advisors are likely to debate the cost and benefits of the waiver of litigation venue rights as a prerequisite for proxy access nominations.
- In conjunction with the exclusive venue provision, nominating shareholders will need to assume all liability stemming from an action, suit or proceeding concerning any actual or alleged legal or regulatory violation arising out of any communication by the nominating shareholder or any of its nominees with the bank, its shareholders or any other person in connection with the nomination or election of directors. The nominating shareholder may also need to indemnify the bank, its affiliates, and each of their respective directors, officers and employees, effectively assuming all of the legal risk arising out of or in any way relating to the submission of the nomination notice. In effect, this provision may deter any would-be nominating shareholders from being the first-mover given the potential for legal risk which may be brought forth by other parties and which are out of the control of the nominating shareholder.

Likely Not a Viable Tactic for Activists

Both banks’ Policy contains the oft-included provision requiring the nominating shareholder to make representations and warranties that their shares were acquired in ordinary course and not for the purpose or with the effect of influence or changing control. The Policy further allows the banks to omit nominees when shareholders solicit proxies (including a withhold campaign for one or more directors) other than solely in support of proxy access nominees or any management nominees through exempt solicitation.

Recall that in the U.S., the first test case for proxy access was by GAMCO Asset Management Inc. through a Schedule 14N filing on November 10, 2016, nominating one director at National Fuel Gas Company. The nomination was challenged by National Fuel Gas, arguing that the proxy access protocols were “limited for

use by an investor who wants to nominate a board candidate but has not advocated and is not advocating to change or influence control of the Company". The GAMCO nomination was withdrawn shortly thereafter. In this case, because GAMCO was a Schedule 13D filer it was relatively clear cut to determine the control intent. In Canada, it may be much harder to determine the control intent. While in the U.S. the Schedule 13D initial reporting threshold is 5%, the equivalent Early Warning Report has a 10% threshold making it more difficult for issuers to determine control intent for sub-10% holders. These aspects of proxy access will likely unravel as the Policy is actually tested through first-time users like in the case of GAMCO.

This past month we saw New York based hedge fund Paulson & Co., call for the largest shareholders of gold mining stocks to form a "Shareholder's Gold Council" coalition to target the issues of executive compensation, board appointment, and value-destroying mergers and acquisitions. The coalition, which would issue vote recommendations to member shareholders, may create unintended consequences for institutions seeking to nominate directors through proxy access. For example, if concerted withhold campaigns are held by the coalition, its members may be ineligible to use proxy access as per the Policy of TD and RBC.

The Path Forward

Currently, TD and RBC's Policy is being adopted in a bank policy form even though the shareholder proposal asked for a proxy access bylaw. As a general guideline, ISS will review all bylaws of an issuer in their entirety should a bylaw resolution be put to a shareholder vote. By adopting proxy access in policy form, issuers may be able to circumvent ISS' wholesome review which may uncover problematic provisions elsewhere in the bylaws such as the advance notice provisions. It remains to be seen whether TD or RBC will put forth the Policy for shareholder approval at their 2018 annual meetings.

Other large financial institutions will likely be next to be targeted by shareholder proposal proponents with other industries to follow. In the U.S., proxy access shareholder proposals were jump-started by New York City's Comptroller through the "Boardroom Accountability Project" which targeted companies with non-binding shareholder proxy access proposals. We believe it is likely that some Canadian market participants will take-up a similar leading role in submitting such shareholder proposals, leading to widespread adoption of proxy access.

Effects on the Broader Market

While proxy access may not prove effective for shareholders with activist tendencies as discussed above, proxy access may inadvertently become the vehicle of choice for the promotion of boardroom diversity. The 30% Club of Canada aims to push for 30% of board seats and C-Suites to be held by women by 2022. Long-term institutional shareholders may find that, once widespread, proxy access could be a preferred pathway towards nominating female directors on stale or stagnant boards.

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