



CANADIAN SHAREHOLDERS ENGAGE WITH U.S.-STYLE PROXY ACCESS

A BRAVE NEW WORLD, OR MUCH ADO ABOUT NOTHING?

OVERVIEW

Shareholders of the Toronto-Dominion Bank ("TD Bank") and the Royal Bank of Canada ("RBC") voted in the last few weeks on shareholder proposals made to confer additional proxy access rights to shareholders in the nomination of directors to the respective boards of the banks. TD Bank shareholders voted in favour of the proposal; RBC shareholders voted against the proposal.

Some Canadian observers gushed over "history being made", shareholders "drawing first blood", and the "floodgates" being opened to further proposals. And to a degree, it is true that these are notable developments in Canada.

But Canada has had statutory "proxy access" rights for decades, and they have rarely, if ever, been used. Moreover, the shareholder proposals made at TD Bank and RBC, even if adopted into a bylaw, would make little difference in reality, given the market caps of these banks. To take the RBC example, it would have lowered the shareholding threshold to nominate directors from \$7.2 billion to \$4.3 billion. Shareholders holding \$4.3 billion in stock who seriously want to replace the board are unlikely to seek to replace the board with a 500-word addition to a management information circular: they will have a true proxy contest with a dissident circular.

While it is entirely likely that more shareholder proposals for proxy access will emerge in the 2017 and 2018 proxy seasons (it is relatively easy and inexpensive to make such a proposal) and while many of those proposals are likely to pass, there is good reason to doubt that this U.S.-style proxy access is likely to make any material difference in how directors are elected in Canada.

HIGHLIGHTS:

- Proxy access proposals made for two Canadian banks
- TD shareholders voted in favour
- RBC shareholders voted against
- ISS supported proxy access proposals
- Corporate governance organizations in Canada supporting
- Likely to see more proposals in 2017 and 2018 proxy seasons
- Unlikely to make any material difference given infrequent use of existing statutory rights

PROXY ACCESS IN CANADA VS. THE U.S.

“Proxy access”, in short, is the ability of shareholders to nominate their own candidates for the election of directors, to be listed as alternatives to the nominees advanced by the company.

Proxy access is to be distinguished from outright proxy contests. Shareholders north and south of the border always have the right to engage in a full-scale proxy contest campaign. In a proxy contest, the nominating shareholder prepares its own circular or proxy statement, hires proxy solicitors, lawyers, and public relations firms, and it is a full-scale election campaign that can often be quite acrimonious.

Proxy access is designed to be less acrimonious and considerably less costly to the shareholder. Provided that the shareholder meets the required threshold of shareholdings, and complies with the statutory (Canada) or company bylaw (U.S.) rules, the company will include that shareholder’s slate of directors in the company’s materials to be mailed out to shareholders. Corporate governance organizations in Canada and the U.S. have been supportive of proxy access provisions, largely in the name of shareholder democracy and shareholder involvement.

We explained the differences in proxy access provisions in Canada and the U.S. in an update released in December 2016, [A Tale of Two Countries: Developments in Proxy Access](#). In Canada, federal and provincial statutes give a right of proxy access to shareholders. Shareholders who: (a) hold at least 5% of the shares of the issuer; (b) have held those shares for at least six months; and (c) who are entitled to vote at the shareholder meeting may submit a shareholder proposal that includes director nominations.

In the United States, by contrast, there is no statutory right for director nominations to be made by way of shareholder proposal. Company bylaws are needed to confer that right, and the proxy access votes that have been seen over the last few years in the U.S. relate to whether companies will adopt such a bylaw.

CANADA’S FIRST LOOK AT PROXY ACCESS SHAREHOLDER PROPOSALS

TD Bank and RBC are very large enterprises in Canada. Both banks have market caps in excess of \$120 billion, net revenues in the tens of billions and assets in the trillions. To get to the 5% threshold to make a shareholder proposal containing director nominees, a shareholder (or combination of shareholders) would need to hold \$6.2 billion in TD Bank stock, or \$7.2 billion in RBC stock. Suffice to say, neither of these banks has ever faced shareholder proposals for director nominees from billion-dollar shareholders using the statutory rules.

In March and April 2017, shareholders of these banks voted on whether to adopt a proposal made by a single shareholder, who was an accountant in eastern Canada. The proposal was the same for both banks. It would allow shareholders to nominate directors for election, in the following manner:

- Shareholders individually or collectively holding 3% of the issued and outstanding shares, and who held these shares continually for the last three years, could make the nomination; and
- Up to 25% of the board could be nominated by shareholders.

The shareholder stated that, in his view, the proxy access proposal would “make directors more accountable and enhance shareholder value.”

Neither of the banks recommended that shareholders vote in favour of the proxy access proposal. The banks listed a number of reasons why shareholders should vote against the proposal:

- The proposals mirrored U.S. proxy access proposals, which do not reflect the legal differences in Canada.
- Shareholders already have statutory proxy access rights in Canada.
- The proposals were not “aligned” with the existing statutory rights in Canada.

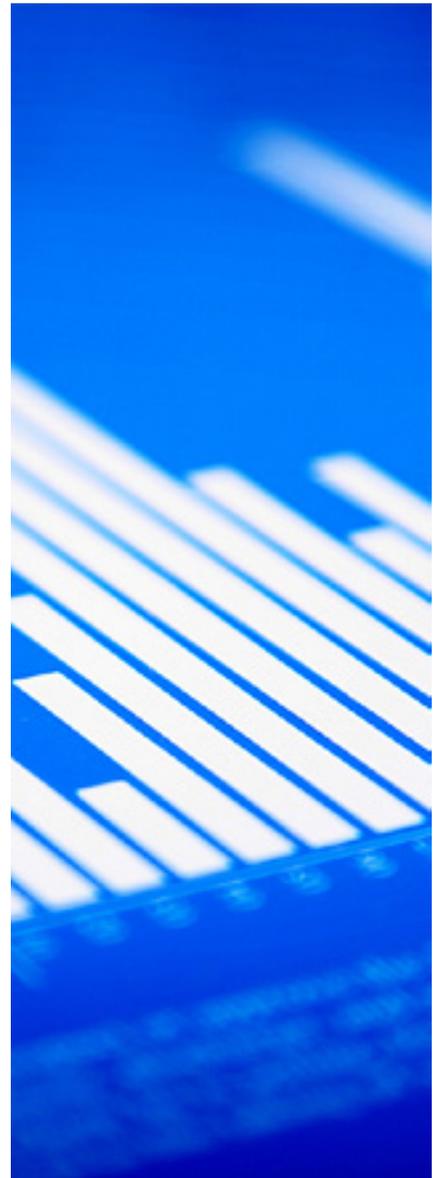
- The banks had a process for identifying and recommending board nominees that would serve the long-term interests of the banks and their shareholders. The proposals would bypass this process.
- Board elections could be contested more frequently, and divisive proxy contests could disrupt the effective functioning of the boards.
- The prospect of standing for election in contested situations could deter highly qualified individuals from board service.
- The nomination and election of directors representing shareholders holding only 3% of the shares could create factions on the board, impeding its effectiveness.
- Lower thresholds for proxy access could promote the influence of special interest groups, by facilitating the nomination and election of directors who seek to further the particular agendas of the shareholders who nominated them, rather than the interests of all shareholders.

Some of these arguments have been advanced in the proxy access debate in the past, for example in the Institute for Governance of Private and Public Organizations [policy paper](#) on the subject.

Some of these arguments would seem to be far more apposite for smaller market cap companies than the banks, given their market cap. Nonetheless, the proposal was consistent with the [position taken](#) by the Canadian Coalition for Good Governance (CCGG)'s policy, and was supported by the shareholder advisory firm, Institutional Shareholder Services ("ISS"). The matter went to a vote at the annual meetings for both of the banks: TD was first, on March 30 2017, followed by RBC on April 6, 2017.

TD Bank shareholders voted 52.2% in favour of the proxy access proposal. And shareholders were discerning with their vote – all of the other shareholder proposals, relating to board composition, executive compensation, and other matters, received only between 1 to 3% of the vote. RBC shareholders went the other way. Only 46.8% of RBC shareholders supported the proxy access proposal.

Shortly before the vote, TD Bank issued a statement saying that it would continue the "dialogue" with stakeholders to consider "how best to give effect to an enhanced regime for proxy access for TD." Similarly, RBC's board pledged to "engage" with shareholders and other stakeholders and to report back at the 2018 annual meeting on the results.



THE AFTERMATH: MUCH ADO ABOUT NOTHING?

The question of proxy access has been the subject of considerable debate in Canada and the U.S., and these developments with TD Bank and RBC are likely to continue the discussion in this country. But even if proxy access proposals are advanced for other Canadian companies, it is reasonable to ask whether this would make any material difference in the way Canadian directors are elected, in practice. Specifically:

Proxy Access is Rarely Used in Canada

As noted by CCGG, the existing proxy access rights in Canada are “rarely” (if ever) used. Various explanations for this are offered: shareholder nominees are only given 500 words in a circular, whereas the company has unlimited space to extoll the virtues of the company slate; shareholders can only directly solicit up to 15 other shareholders without preparing a dissident circular; and proposals effectively need to be made four to six months in advance of the meeting. All of these are valid points, but in addition, there is the reality that this is simply a difficult and ineffective way to run a campaign. Even if shareholder candidates are listed more prominently and with more detail than the 500-word limit currently allows in the management circular, this would still be an extremely poor substitute to running an actual proxy contest. Even full-blown proxy contests, which are now getting sufficiently sophisticated that shareholders are disseminating polished videos attacking incumbents (see Elliott Management’s recent video attacking Arconic Inc., for example), regularly fail. In 2015 and 2016, proxy contests that went all the way to a vote resulted in management succeeding more often than the activist.

The 20/25% vs. 100% Distinction in the Age of Majority-Voting

CCGG’s proposal was to allow shareholders to propose up to 20% of the nominees for election. It similarly would try to prevent “creeping board control” by prohibiting shareholder nominees in years subsequent to such an election. The banks pointed out that the statutory proxy access rights allowed for the nomination of the whole board, not 25% as proposed by the shareholder. But as a result of the 2014 Toronto Stock Exchange (TSX) amendments to the TSX *Company Manual*, companies listed on Canada’s major stock exchange already have

majority-voting requirements. This means that any director who receives less than a majority vote “for” his or her election at a contested meeting is required to tender his or her resignation immediately after the election. The board then has 90 days to decide whether to accept the resignation, and the board is required to accept that resignation except in “exceptional circumstances.” Given the ability of shareholders to effectively force the resignation of other candidates not proposed by the shareholders, it is not clear that this would make much of a difference in practice.

The 5% vs. 3% Threshold in Actual Contested Situations

As discussed above, the statutory threshold for shareholder proposals in Canada is 5%, whereas the proposals for the banks would set the threshold at 3%. Does this make a difference? For massive market cap companies such as the banks, it is difficult to see how it would make a difference in practice. But even for smaller market cap companies, it is unlikely to make a difference. Research shows that, for the average activist campaign in North America over the past few years, the dissident shareholder(s) held 6% of the outstanding shares of the company. If the average dissident campaign already involves 6% of the shares, it makes no difference whether the threshold is 3% or 5%; the threshold will be met in either scenario.

Proxy Access Bylaws are Likely to be Restrictive and Iterative

If the U.S. experience is any guide, even if a shareholder proposal for proxy access succeeds in Canada, it may be years before the details are worked out in a manner that results in meaningful shareholder proxy access. Shareholder bylaws in the U.S. have seen the following features that critics have complained diminish proxy access rights:

- *Shareholder Representations*: A shareholder normally must represent that they hold the requisite shares (and proof of such holding will be required). But other representations might be required, such as a representation that the shares were acquired in the ordinary course of business and not with the intent to change or influence control of the company. Such a requirement could be, and has been, invoked to limit proxy access only to passive holders who hold the shares only for investment purposes.

- *Holding Periods*: The statutes in Canada require a shareholder holding the requisite percentage of shares to have held those shares for six months. The shareholder's proposal for the banks was for a three-year holding period. Longer holding periods are obviously designed to discourage proxy access use by short-term activist investors.
- *Prohibition on Resubmissions*: Most proxy access bylaws in the U.S. contain a provision of some form that prohibits resubmissions of failed nominees in subsequent years.
- *Restrictions on Third-Party Compensation of Proxy Access Nominees*: Although infrequent in the U.S., some proxy access bylaws have prohibited third-party compensation in connection with a candidacy.
- *Counting Individual Related Funds as Individual Shareholders for Aggregation*: All proxy access bylaws establish their threshold (usually 3%) based on individual share ownership or collective share ownership, up to a specified maximum (usually 20 shareholders). Some proxy access bylaws define "shareholders" as counting individual funds within a mutual fund family as separate shareholders for purposes of an aggregation limit.
- *Post-Meeting Shareholding Requirements*: Some proxy access bylaws contain a requirement that the proponent must intend to hold its shares for some period of time past the date of the shareholder meeting.

Some of the restrictive elements of certain proxy access bylaws have been criticized by shareholder advisory firms ISS and Glass Lewis, and have led to what are known as "fix it" shareholder proposals, where some of these restrictive elements are proposed to be amended.

CONCLUSIONS

It is relatively inexpensive and straightforward to make a proposal for proxy access to a Canadian public issuer. For this reason alone, we are likely to see additional copycat proxy access proposals being made in Canada. But even if proposals are made, and adopted by shareholders, if Canadian history is any guide, this new form of Canadian proxy access will be rarely if ever used. And even if it is used, it is difficult to see how a shareholder slate could succeed over the company slate, unless those dissidents actually engaged in a full-blown proxy contest. And for shareholders willing to engage in a full proxy contest, these forms of proxy access rights are not particularly important.

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