Canadian Coalition for
GOOD GOVERNANCE

THE VOICE OF THE SHAREHOLDER

October 3, 2017

Director
Financial Institutions Division
Financial Sector Policy Branch
Department of Finance Canada
James Michael Flaherty Building
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Email: fin.legislativereview-examenlegislatif.fin@canada.ca

Dear Sir/Madam:

Re: Department of Finance Canada: Second Consultation Paper for the Review of the Federal Financial Sector Framework *Potential Policy Measures to Support a Strong and Growing Economy: Positioning Canada's Financial Sector for the Future* (the "Consultation Paper")

The Canadian Coalition for Good Governance ("CCGG") has reviewed the Consultation Paper and we thank you for the opportunity to provide our comments.

CCGG's members are Canadian institutional investors that together manage approximately $3 trillion in assets on behalf of pension funds, mutual fund unit holders, and other institutional and individual investors. CCGG promotes good governance practices in Canadian public companies and the improvement of the regulatory environment in order to best align the interests of boards and management with those of their shareholders and to promote the efficiency and effectiveness of the Canadian capital markets.

A list of our members is attached to this submission as Appendix 1.

OVERVIEW

CCGG supports the Department of Finance Canada's efforts to renew the federal financial institutions statutes in order to position the federal financial sector framework for the future and to ensure that it continues to meet the changing needs of Canadians.

CCGG's mandate is the improvement of corporate governance at Canadian public companies, which includes the governance of financial institutions which are public companies. Accordingly, we welcome the opportunity to provide our views on the proposed potential policy measures as well as provide input on policy direction for future work but we restrict our comments here to (i) the corporate governance measures considered under the "Modernizing the Framework" section of the Consultation Paper as they apply to Canadian publicly listed financial institutions and (ii) additional matters for consideration that we believe are fundamental to strengthening the corporate governance framework of financial institutions going forward.

The governance of public companies, in particular financial institutions given the potential for systematic impact of governance failures at these institutions, has important ramifications for the capital markets and beyond. The good governance of financial institutions is also critical to the stability of the financial sector. A corporate governance framework that enables directors, management and shareholders to fulfill their obligations as well as meaningfully exercise their rights is essential if our public corporations are going to serve their market role of enhancing long term sustainable value and creating prosperity for society generally. It has long been acknowledged that good governance is critical to meeting these goals.

CCGG is very pleased to see that the Department of Finance Canada (the "Department of Finance") has asked for comments on potential policy measures (the "Policy Measures") that we believe, if adopted, would significantly improve the corporate governance practices of Canadian financial institutions and enhance public confidence in the financial sector. The Policy Measures, modeled on provisions found in Bill C-25 which seeks to amend the Canada Business Corporations Act and is currently before the Senate, would strengthen shareholder democracy in the election of directors and promote diversity on boards. We believe the Policy Measures are critical to modernizing the financial sector framework. CCGG had recommended in our response to the Department's 2016 first consultation on the federal financial sector framework that the federal statutes governing public financial institutions be amended in a manner similar to the amendments proposed in Bill C-25 (the "Proposed CBCA Amendments"). Accordingly, we welcome the opportunity to express our strong support for the Policy Measures as outlined in the Consultation Paper.

We respond below to the specific requests for comment set out in the Consultation Paper. We also outline additional proposals to amend the federal statutes governing public financial institutions that we believe are critical if the framework is to continue to respond to rising public expectations of corporate governance that will support the safety and soundness of the financial system.

RESPONSES TO SPECIFIC REQUESTS FOR COMMENTS

Promoting Diversity on Boards

CCGG supports the focus on addressing lack of diversity on boards and in senior management, both as a fairness issue and as a business issue, given that research shows that diversity enhances the quality of decision making, independence and the oversight and mitigation of risk, as well as corporate performance.[1] As CCGG's 2013 *Building High Performance Boards* states, boards should reflect a wide variety of experiences, views and backgrounds, which to the extent practicable reflect the gender, ethnic, cultural and other personal characteristics of the communities in which the corporation operates and sells its goods or services.[2] The same principle applies to senior management.

CCGG supports the implementation of a 'comply or explain" model to promote the participation of women on boards of directors and in senior management of federally regulated financial institutions. We believe that the diversity provisions in CSA NI 58-201 provide a good model for the Department to consider, with the caveat that the CSA continues to review disclosure under those provisions to assess whether it will be effective in increasing the number of women on boards and in senior management and, if not, have suggested that further action may be taken. We recommend that the Department of Finance monitor progress under NI 58-201 with an eye to that experience informing the steps taken with respect to federal financial institutions.

Because women comprise half the population, CCGG believes that the lack of gender diversity on boards and in senior management is an obvious form of lack of representation that needs to be addressed and a good place to start. We note, however, that CCGG strongly supports addressing the lack of other forms of diversity on boards and in senior management as well.[3] We understand that consideration is being given by the federal government to incorporating a notion of diversity broader than gender into Bill C-25 and, again, we encourage the Department of Finance to monitor the progress of Bill C-25 for insights into the appropriate 'comply or explain' framework for federal financial institutions.

Strengthening Shareholder Democracy in the Election of Directors

Establishing Annual Elections

The Department of Finance should amend the relevant statutes to require that the directors of all public financial institutions are elected for fixed one-year terms.

While we are not convinced that a transition period is needed for small institutions, CCGG has no objection to the Department providing a two-year transition period for these institutions.

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[1] *Different if Better: Why Diversity Matters in the Boardroom* http://www.russellreynolds.com/content/different-better; (2010, October). Better Decisions through Diversity: Heterogeneity Can Boost Group Performance. Kellogg Insight. Kellogg School of Management at Northwestern University; https://www.credit-suisse.com/newsletter/doc/gender_diversity.pdf; *"Women Matter: gender diversity, a corporate performance driver",* McKinsey, & Company, 2007; "*The Bottom Line: Corporate Performance and Women's Representation on Boards*", Lois Joy, Nancy M. Carter, Harvey M. Wagener, Sriram Narayanan; "*Mining the Metrics of Board Diversity*", June 2013 Thomson Reuters; "*Women on Boards"* February 2011, UK, pages 7-9 (the "Davies Report")

[2] http://www.ccgg.ca/site/ccgg/assets/pdf/building_high_performance_boards_august_2013_v12_formatted__sept._19,_2013_last_update_.pdf page 9

[3] See CCGG's Board Gender Diversity Policy, October 2015

Mandating Individual Director Elections

CCGG believes that individual director elections, rather than slate ballots, should be mandatory for all federally regulated financial institutions. Being able to hold individual directors accountable is fundamental to meaningful shareholder democracy.

Again, while we not convinced that a transition period is needed for small financial institutions, CCGG has no objection to the Department providing a two-year transition period for these institutions.

Majority Voting for Directors of the Board in Uncontested Elections

CCGG believes there should be a majority voting standard for all public companies and therefore CCGG strongly supports the adoption of a majority voting standards in uncontested director elections for all federally regulated financial institutions. We believe that it should be a matter of law that directors who do not receive a majority of shareholder votes in favour are not elected to the board.[4] A true majority voting standard for uncontested director elections, as opposed to the plurality standard currently found in the legislation governing Canadian public corporations, including financial institutions, is fundamental to shareholder democracy since under a plurality system directors are not truly accountable to shareholders.

Some commentators express concerns about disruption to the operations of a board and continued board stability under a majority voting standard in the case of a failed election of a candidate, or in the event that not enough directors are elected to constitute a quorum or for the company to be able to stay onside bank regulations with respect to board and committee independence or Canadian residency requirements or if there are no directors elected (which even those opposed to statutory majority voting agree would constitute an extremely rare event). Such concerns are unwarranted since the current Bank Act contains detailed provisions that address these sorts of situations by providing the board with procedures to follow.[5]

Some commentators are also concerned about what will happen to the carefully constructed balance of skills and expertise created by Nomination Committees if a director nominee selected by the Committee is not elected and the board must appoint another person. Current best practices require that a board maintain an evergreen list of potential board candidates for situations where unexpected events occur, for example, the death of a board member, so the board is not blindsided. The same evergreen list should provide a solution in the case of a failed election where the board's nominee is not elected. In any event, the alternative that would see board discretion exercised to keep or place a director nominee on the board who has failed to receive a majority of shareholder votes in favour, is unacceptable on principle.

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[4] While the TSX in 2014 amended its listing requirements so that its listed issuers must adopt a majority voting policy in uncontested director elections essentially identical to the majority voting policy that CCGG proposed in 2006, the TSX policy is only a 'work around' the fact that the law still provides for plurality voting. The TSX listing requirements provide a board with discretion as to whether to accept the resignation of a director who has failed to receive a majority of votes in favour, leading to the phenomenon of what have been called 'zombie directors' when the resignations are not accepted. Also, the rule applies only to TSX listed issuers (and not to over 1600 TSX-V listed issuers or other public companies not listed on the TSX) and the TSX could change the requirement in the future.

[5] See Appendix 2 for the relevant sections of the Bank Act.

PROPOSALS FOR ADDITIONAL AMENDMENTS TO FEDERAL FINANCIAL INSTITUTION REGULATION

In addition to supporting the Bill C-25 and its provisions respecting majority voting, annual elections and diversity on boards and in senior management, we asked the federal government to amend the CBCA to adopt other provisions important for good governance and shareholder rights. These other provisions are as relevant and important for public financial institutions as well and we encourage the Department of Finance to adopt them.

Shareholder Involvement in the Director Nomination Process – Enhanced Proxy Access

CCGG strongly encourages the Department of Finance to work to amend the Bank Act, as well as the legislation governing other federal publicly listed financial institutions, to provide for what CCGG refers to as "enhanced proxy access", that is, the ability of shareholders meeting certain conditions to nominate directors to the proxy on an equal footing with management nominees. As discussed below, there have been significant developments in proxy access recently, both in Canada and the U.S., and CCGG is of the view that the Department of Finance should take this rare opportunity available to amend the Bank Act and other federal financial institution legalisation to reflect these developments.

CCGG's support of enhanced proxy access flows from our belief that shareholders' ability to have a meaningful say in which persons are put forward as director nominees is a fundamental right which provides substance to the shareholders right to elect directors. So, as discussed in our 2015 policy entitled *Shareholder Involvement in the Director Nomination Process: Enhanced Engagement and Proxy Access* (the "2015 Policy"), directors, as a matter of course and on a regular basis, should seek input from shareholders in the director nominating process and thus board composition. However, in situations where shareholder input is consistently ignored, which we believe will happen very rarely, shareholders also should have the right to nominate directors through enhanced proxy access.[6] The form of enhanced proxy access that CCGG supports (and which will be set out in a forthcoming CCGG publication) would permit shareholders holding 3% of a company's outstanding shares for a period of 3 years to nominate up to 20% of the board of directors, providing that control of the company is not being sought. In addition, shareholder nominees should be placed on the same universal proxy as management nominees, information about those nominees should be placed in the company' s proxy circular with equal prominence as management nominees and the shareholders nominating the directors should be able to use that proxy circular as the basis for soliciting proxies without a dissident proxy circular being required.

Recent Developments in Proxy Access

Since our 2015 Policy was released, proxy access has become mainstream in the U.S., with more than 425 companies of various sizes and across industries, including more than 60% of the companies in the S&P 500 index, having enacted proxy access bylaws which give shareholders the right to nominate directors provided certain conditions are met. The standard set of conditions which has emerged in the

[6] We call it 'enhanced' because shareholders under the Bank Act (and Canadian corporate statutes) currently have certain rights to nominate directors but those rights, as discussed in our 2015 Policy, are impracticable to exercise.

U.S. in the last two years provide that shareholders holding at least 3% of the company's outstanding shares for a minimum of 3 years can nominate up to a specified percentage of the directors on the company's proxy.[7]

It seems that a similar form of proxy access is starting to make inroads into Canada as well. Shareholder proposals requesting the adoption of proxy access by-laws, very similar to the standard U.S. form[8], were submitted in 2017 at Toronto Dominion Bank ("TD") and Royal Bank of Canada ("RBC") and did exceptionally well given that these were the first shareholder proposal in Canada seeking proxy access, receiving a vote of 52.2% in favour at TD and 46.8% in favour at RBC. Both banks committed publicly to working with their stakeholders, including CCGG, to develop an enhanced regime for proxy access[9] and, on September 29, 2017, each bank posted the same Proxy Access Policy (the "Bank Proxy Access Policy") on their respective websites (here and here).

The Bank Proxy Access Policy differs from the standard U.S. form in that shareholders must hold 5% of the outstanding shares, rather than 3%, in order to nominate directors. We understand that TD and RBC are of the view that because the Bank Act has a provision (similar to that found in the various Canadian corporate statute) that permits shareholders holding 5% of the outstanding shares to submit a shareholder proposal nominating directors, banks are prohibited from permitting shareholders holding 3% of the outstanding shares to nominate directors. CCGG does not agree with this position. However, also on September 29, TD and RBC released on their respective websites a joint letter to the federal government proposing amendments to the Bank Act and its corresponding regulations to permit Canadian banks to provide proxy access to their shareholders on a basis consistent with the standard U.S. form. The letter includes proposed amendments to the relevant provisions of the Bank Act. The adoption of such amendments would enable TD and RBC to accede to shareholder wishes for enhanced proxy access along the lines that CCGG is proposing and consistent with the terms contained in the shareholder proposals submitted to the banks. We are hopeful that the letter from these banks in conjunction with this submission of CCGG on behalf of our institutional shareholder members will be persuasive. Accordingly, CCGG encourages the Department of Finance Canada to take the initiative to amend the Bank Act to include shareholder access to the proxy under the proposed conditions, just as we have encouraged the federal government to amend the CBCA in a similar fashion.[10]

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[7] There are additional conditions in the U.S. model, which are also important (such as a requirement to certify that the nominating shareholder is not seeking control or limits on the number of shareholders whose holdings can be aggregated to reach the specified thresholding) but the three referred to here are the primary consistent features of the U.S. model.

[8] The shareholder proposals submitted at TD and RBC differed from what is now standard in the U.S. in that, while the U.S. form typically permits shareholders to nominate up to 20% of the directors, the TD and RBC shareholder proposals set a higher cap of 25%.

[9] RBC Directors to Engage with Shareholders and other Stakeholders on Proxy Access and TD Message re Proxy Access.

[10] We note that CCGG has not yet determined whether it would be preferable to incorporate enhanced proxy access into the Bank Act through a new standalone provision or, as proposed by the banks, by amending the existing 143(4) of the Bank Act.

We also wish to see the Bank Act and other federal financial institution legislation specify that financial institutions providing shareholders with enhanced proxy access must do so in the form of a bylaw that has been approved by shareholders and which will require shareholder approval to amend or repeal, rather than in the form of a policy as TD and RBC have done. Enhanced proxy access that is adopted by means of board policy (rather than a bylaw) does not provide enough security that proxy access will continue to be protected since board policies can be change at the discretion of the board.

While we recognize that many stakeholders in Canada are uneasy with the concept, CCGG believes that, like majority voting, enhanced proxy access will come to be seen as another manifestation of a meaningful shareholder franchise and one of the foundations of good corporate governance.

Say on Pay

Canada is an outlier among developed nations in not having a mandatory say on pay vote that allows shareholders to voice their views on the appropriateness of an issuer's executive compensation practices. In some countries, say on pay votes are advisory in nature, such as those mandated in the U.S. since 2011 under the Dodd-Frank Wall Street Reform and Consumer Protection Act, and in other countries they are binding, as in the U.K. and Switzerland. CCGG believes that the statutes pursuant to which public financial institutions are incorporated should be amended to provide for an annual advisory say on pay vote for all publicly listed institutions governed by those statutes.

Say on pay already has been adopted voluntarily by approximately 175 of Canada's largest issuers and those aspiring to best practices, a trend which was led by Canada's leading financial institutions and which have been at the forefront of the adoption of say on pay in Canada. Say and pay is viewed widely as having significantly improved the quality of issuer disclosure in Canada and to have increased productive engagement between shareholders and boards. It is important that the playing field be consistent and level, in order that shareholders of all public companies, including all public financial institutions, have this ability and that all directors benefit from this form of shareholder communication.

Separation of the Roles of the Chief Executive Officer (CEO) and the Chair of the Board

For all issuers, there is an inherent conflict of interest when the Chair of a company's board also serves as the CEO of that company. The oversight of management, in particular the CEO, is one of the board's key responsibilities and a combined Chair/CEO is thus responsible for leading the body that oversees himself or herself. Other important responsibilities of the Chair are compromised when the role is shared: setting the agenda for board meetings, ensuring directors receive the necessary information and that board meetings are conducted with open discussion and an independent assessment of management views. Similar challenges are presented when the Chair is not wholly independent of management. Accordingly, it is CCGG's position that as a basic tenet of good governance the CEO should not also serve as the Chair and, further, that the Chair should be independent of management. CCGG believes this cardinal rule should be made explicit in the Bank Act as well as in other federal statutes that govern publicly listed financial institutions.

The statutes could provide for a transitional period for issuers that currently combine the roles pursuant to which boards could appoint a lead director independent of management to carry out the functions of the Chair of the board as the board moves toward completely separating the roles of CEO and Chair.

SUMMARY

The opportunity to amend the statutes governing federal financial institutions provides a rare opportunity to enhance the corporate governance of Canadian publicly listed financial institutions in important ways. CCGG is pleased to be able to provide our comments on the Consultation Paper and strongly encourages the Department of Finance to take full advantage of this opportunity to position Canada in the forefront of good governance practices at publicly listed financial institutions and thereby assist in promoting the stability, efficiency and utility of the Canadian financial markets.

Thank you for the opportunity to provide you with our comments. If you have any questions regarding the above, please feel free to contact our Executive Director, Stephen Erlichman, at 416-847-0524 or serlichman@ccgg.ca or our Director of Policy Development, Catherine McCall, at 416.868.3582 or cmccall@ccgg.ca.

Yours very truly,

Julie Cays,
Chair of the Board of Directors
Canadian Coalition for Good Governance

CCGG Members – October 2017

Alberta Investment Management Corporation (AIMCo)

Alberta Teachers' Retirement Fund (ATRF)

Archdiocese of Toronto

BlackRock Asset Management Canada Limited

BMO Asset Management Inc.

British Columbia Investment Management Corporation (bcIMC)

Burgundy Asset Management Ltd.

Caisse de dépot et placement du Québec

Canada Pension Plan Investment Board (CPPIB)

Canada Post Corporation Registered Pension Plan

CIBC Asset Management Inc.

Colleges of Applied Arts and Technology Pension Plan (CAAT)

Connor, Clark & Lunn Investment Management Ltd.

Desjardins Global Asset Management

Electrical Safety Authority (ESA)

Fiera Capital Corporation

Franklin Templeton Investments Corp.

Greystone Managed Investments Inc.

Healthcare of Ontario Pension Plan (HOOPP)

Hillsdale Investment Management Inc.

Industrial Alliance Investment Management Inc.

Jarislowsky Fraser Limited

Leith Wheeler Investment Counsel

Lincluden Investment Management Limited

Mackenzie Financial Corporation

Manulife Asset Management Limited

NAV Canada

Northwest & Ethical Investments L.P. (NEI Investments)

OceanRock Investments Inc.

Ontario Municipal Employee Retirement System (OMERS)

Ontario Pension Board

Ontario Teachers' Pension Plan (OTPP)

OPSEU Pension Trust

PCJ Investment Counsel Ltd.

Pension Plan of the United Church of Canada

Pier 21 Asset Management Inc.

Public Sector Pension Investment Board (PSP Investments)

RBC Global Asset Management Inc.

Régimes de retraite de la Société de transport de Montréal (STM)

Scotia Global Asset Management

Sionna Investment Managers Inc.

State Street Global Advisors, Ltd. (SSgA)

Sun Life Investment Management Inc. (SLIM)

TD Asset Management Inc.

Teachers' Retirement Allowances Fund

UBC Investment Management Trust Inc.

University of Toronto Asset Management Corporation

Vestcor Investment Management Corporation

Workers' Compensation Board - Alberta

York University

Appendix 2

The Bank Act:

Incomplete Elections and Director Vacancies

Void election or appointment

170 (1) If, immediately after the time of any purported election or appointment of directors, the board of directors would fail to comply with subsection 159(2) [*re: Canadian board residency requirements*] or 163(1) [*re restrictions on directors being affiliated with the bank*] or section 164 *[re restrictions on number of board bank employees*], the purported election or appointment of all persons purported to be elected or appointed at that time is void unless the directors, within forty-five days after the discovery of the non-compliance, develop a plan, approved by the Superintendent, to rectify the non-compliance.

Failure to elect minimum

(2) If, at the close of a meeting of shareholders or members of a bank, the shareholders or members have failed to elect the number or minimum number of directors required by this Act or the by-laws of a bank, the purported election of directors at the meeting

- **(a)** is valid if the directors purported to be elected and those incumbent directors, if any, whose terms did not expire at the close of the meeting, together constitute a quorum; or
- **(b)** is void if the directors purported to be elected and those incumbent directors, if any, whose terms did not expire at the close of the meeting, together do not constitute a quorum.

Directors where elections or appointments incomplete or void

171 (1) Despite subsections 166(2) and (3) and paragraphs 168(1)(f) and 172(1)(a), if subsection 170(1) or (2) applies at the close of any meeting of shareholders or members of a bank, the board of directors, until their successors are elected or appointed, consists solely of

- **(a)** where paragraph 170(2)(a) applies, the directors referred to in that paragraph; or
- **(b)** where subsection 170(1) or paragraph 170(2)(b) applies, the persons who were the incumbent directors immediately before the meeting.

Where there is no approved rectification plan

(2) Notwithstanding subsections 166(2) and (3) and paragraphs 168(1)(f) and 172(1)(a), where a plan to rectify the non-compliance referred to in subsection 170(1) has not been approved by the Superintendent by the end of the forty-five day period referred to in that subsection, the board of directors shall, until their successors are elected or appointed, consist solely of the persons who were the incumbent directors immediately before the meeting at which the purported election or appointment referred to in that subsection occurred.

Directors to call meeting

(3) If subsection (1) or (2) applies, the board of directors referred to in that subsection must, without delay, call a special meeting of shareholders or members, as the case may be, to fill the vacancies if paragraph 170(2)(a) applies, or elect a new board of directors if subsection 170(1) or paragraph 170(2)(b) applies.

Others may call meeting

(4) If the directors fail to call a special meeting required by subsection (3), the meeting may be called by any person who would be entitled to vote at the meeting.