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Are the Floodgates Open in Canada? First Proxy Access Bylaw Proposal Receives Narrow Majority Shareholder Approval

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History was made yesterday when the shareholders of Toronto-Dominion Bank (TD Bank) narrowly approved a shareholder proposal asking the board of directors to take the necessary steps to adopt a "proxy access" bylaw. The proposal, which mirrors another proposal submitted by the same shareholder to Royal Bank of Canada (RBC), is the first proxy access proposal made in Canada. Given the widespread support for proxy access in the United States, and the RBC and TD Bank proposals in Canada, Canadian issuers should prepare to face proposals (formal or informal) to implement proxy access in some form. Companies incorporated under the Ontario *Business Corporations Act* (OBCA) may also see proxy access become a statutory right.

The Proxy Access Proposals and Perspectives

The proxy access proposals were submitted by a Nova Scotia–based shareholder of TD Bank and RBC and included in their respective proxy circulars. The proposed bylaw is similar to the most typical U.S.-style proxy access bylaw, with the following features:

- minimum ownership threshold of 3% of outstanding common shares;
- minimum holding period of three years (in contrast to Canadian Coalition for Good Governance's [CCGG's]) recommended proxy access standard discussed below, which advocates no holding period);
- maximum cap on shareholder appointees at one-quarter of the then-serving directors;
- requiring a universal proxy listing the shareholder's nominee(s) on the bank's proxy card; and
- allowing the nominating shareholder to submit a statement of up to 500 words in support of each nominee to be included in the bank's proxy materials.

The boards of both TD Bank and RBC recommended shareholders vote against the proposals for a number of reasons, including that the proposals mirror the U.S. approach to proxy access without taking into account comparable rights already available to Canadian shareholders under applicable corporate and bank statutes which are not commonly available under U.S. corporate statutes (i.e., the right to nominate candidates for election as directors, and meeting requisition rights referred to below).

In the face of the TD Bank board's negative recommendation, the proxy access proposal narrowly passed at the annual shareholders meeting yesterday, with 52.2% shareholder support. Shareholders of RBC will vote on their proposal at its shareholders meeting scheduled for April 6, 2017. Institutional Shareholder Services (ISS) supported both proposals, as did some major institutional investors.

TD Bank and RBC each announced that they intend to defer their decision as to whether, and in what form, they will implement proxy access. In public statements released prior to their shareholders' meetings, both Banks indicated that prior to receiving the proposals, they had been involved in discussions with CCGG about the Canadian proxy access regime and, as a result of these discussions along with the proxy access proposals received, they are aware that some shareholders support proxy access in principle, but desire more consideration of what the appropriate features of proxy access should be. Both Banks confirmed a commitment to continue the dialogue with stakeholders over the next year to consider an enhanced proxy access regime that may be appropriate for them. They will report back to their respective shareholders in their 2018 proxy circulars.

Background on Proxy Access in Canada and the United States

Proxy access has been a recurring governance issue in Canada and the United States for several years, and has gained significant traction in the United States. By the end of the 2016 proxy season, a majority of S&P 500 U.S. issuers had adopted a proxy access bylaw. However, prior to the TD Bank and RBC proposals no Canadian issuer had received a proposal for or adopted proxy access.

Rather, since CCGG published its May 2015 policy paper proposing a Canadian-style proxy access standard[1] encouraging Canadian public companies to voluntarily adopt proxy access, discussion in Canada has largely been a debate over whether proxy access is necessary or appropriate for Canadian companies and, even if it is, in what form. On one hand, some institutional investors and CCGG have been advocating for proxy access on the basis that the right to directly nominate directors is an essential component of shareholders' right to elect directors and shareholder democracy and companies will benefit from shareholder input into the nomination process. Others question the need for proxy access bylaws in Canada at all. The legal regime in Canada is distinct from the United States and most Canadian corporate laws already include some form of proxy access. For example, most corporate statutes permit shareholders holding a certain percentage of voting shares (usually 5%) to submit a proposal with nominations for the election of directors to be included in management's proxy circular, or to requisition a meeting of shareholders at which they can propose director nominees. Many also cite important differences between the Canadian and U.S. markets – such as the smaller size of the Canadian market, smaller market capitalizations of Canadian issuers and the fact that shares of Canadian issuers tend to be less liquid – all of which magnify the influence of institutional investors in Canada and, together with shareholders' other statutory rights, obviate the need for proxy access.

You can read more about proxy access, shareholder proposals and other top trends and issues in corporate governance in Canada in Davies Governance Insights 2016.

Implications for Canadian Issuers: More Proposals and Engagement on Proxy Access

While shareholder proposals do not compel boards to implement them even when approved by a majority of shareholders, the practical importance of the first-ever proxy access proposal being approved by TD Bank's shareholders (and perhaps the second being approved by RBC's shareholders next week) cannot be understated. As we predicted, we expect other Canadian issuers, and not just banks, will face similar proposals in the 2018 proxy season, if not sooner for those companies that have yet to call and hold their 2017 meetings. Canadian companies should expect greater engagement by shareholders on the topic of proxy access.

Amendments proposed to the OBCA may soon make proxy access a statutorily entrenched right, at least for shareholders of OBCA corporations. If adopted under Bill 101 – *Enhancing Shareholder Rights Act, 2017*, which recently passed second reading in the Ontario Legislative Assembly, the OBCA would be amended to allow registered or beneficial shareholders holding at least 3% of the shares or 3% of the class or series of shares entitled to vote at a meeting, to nominate a single individual director nominee. If a director nominee proposal is submitted, the corporation's proxy card must include the shareholder's nominee and shareholders are entitled to choose a person from their number to chair the meeting. The bill also proposes to reduce the ownership threshold for shareholders to requisition a meeting from 5% to 3%.

Interestingly, the amendments to the *Canada Business Corporations Act* (CBCA) proposed in 2016 under Bill C-25, which passed second reading in the House of Commons, do not contemplate expanding proxy access rights. The shareholder proposal and shareholder requisition rights would remain intact at their current 5% share ownership thresholds. Given that almost half of Canada's largest public companies are incorporated under the CBCA, the OBCA changes as well as initiatives by shareholders to require companies to adopt proxy access bylaws in varying forms may be premature. Among other things, they could result in inconsistencies and unequal shareholder rights among Canada's public companies.

[1]CCGG Policy, "Shareholder Involvement in the Director Nomination Process: Enhanced Engagement and Proxy Access," May 2015. Among other features, CCGG's proxy access standard would permit shareholders holding 5% or 3% (depending on the company's market capitalization) of a company's outstanding shares to nominate directors in the issuer's proxy materials and proxy card, provided that the shareholder continued to hold the requisite amount of shares up to the

time of the meeting. No other holding period was recommended. The number of permitted shareholder nominees proposed was capped at three directors or 20% of the board, whichever is less.

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