Via Email

July 11, 2013

Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
New Brunswick Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department of Justice, Government of
Nunavut
Ontario Securities Commission
Prince Edward Island Securities Office
Autorité des marchés financiers
Saskatchewan Financial Services Commission
Registrar of Securities, Government of Yukon

c/o Mme Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
Tour de la Bourse
800, square Victoria
C.P. 246, 22e étage
Montréal, Québec H4Z 1G3
Email: consultation-en-cours@lautorite.qc.ca

The Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
Fax: (416) 593-8145
E-mail: comments@osc.gov.on.ca

Re: CSA Notice and Request for Comment Draft Regulation to Amend Regulation 62-104 respecting Take-Over Bids and Issuer Bids, and Draft Regulation to Amend Regulation 62-103 respecting Early Warning System and Related Take-Over Bid and Insider Reporting Issues, and Proposed Changes to National Policy 62-203 respecting Take-Over Bids and Issuer Bids

Dear Sirs and Mesdames:

I am writing to you on behalf of the Council of Institutional Investors (“CII”) to express our concerns with the Canadian Securities Administrators’ (“CSA”) CSA Notice and Request for Comment Draft Regulation to Amend Regulation 62-104 respecting Take-Over Bids and Issuer Bids, and Draft Regulation to Amend Regulation 62-103 respecting Early Warning System and Related Take-Over Bid and Insider Reporting Issues, and Proposed Changes to National Policy 62-203 respecting Take-Over Bids and Issuer Bids.
Warning System and Related Take-Over Bid and Insider Reporting Issues, and Proposed Changes to National Policy 62-203 respecting Take-Over Bids and Issuer Bids (collectively, the “Proposal”). Founded in 1985, CII is a Washington, DC based nonprofit, nonpartisan association of public, corporate and union employee benefit plans, foundations and endowments with combined assets that exceed $3 trillion. Our members are large, long-term shareowners responsible for safeguarding the retirement savings of millions of American workers.

I. Concerns Regarding Changing Triggers and Early Warning Thresholds

We are concerned that the Proposal would, as we understand it, apply the proposed early warning threshold of 5% to certain eligible institutional investors (“EII”) currently reporting under the alternative monthly reporting (“AMR”) framework. We are also concerned that the Proposal would, as we understand it, disqualify certain EII’s from the AMR if they “solicit[] or intend[] to solicit proxies from security holders on [certain] matters . . . .” In both circumstances, the Proposal would appear to increase the compliance burden for passive long-term institutional investors and require reporting that is simply not practicable for some funds.

While we are concerned about several of the changes in the Proposal individually, we are also concerned about the aggregate effect of the changes. As we understand it, the Proposal simultaneously disqualifies certain institutional investors from the AMR system while it decreases the reporting threshold, adds a new disclosure of a 2% decrease in ownership and other new and more detailed disclosures, while at the same time maintaining the existing requirement that the investor must issue and file a news release promptly and file a report within 2 business days. In addition to the increased compliance burden the Proposal would appear to present for many long-term institutional investors, the Proposal also raises broader issues about whether establishing a more onerous shareowner reporting regime benefits investors, issuers, and the capital markets generally. Those broader issues should be thoroughly evaluated by the CSA before proceeding with the Proposal. In that regard, we note that in a 2011 comment letter in response to a petition filed with the U.S. Securities and Exchange Commission requesting changes to Section 13(d) of the Securities Exchange Act of 1934 the then Chair of CII’s Policies Committee stated:

Any amendments of Section 13(d) would ideally strike a balance between the competing objectives of providing

---

1 CSA Notice and Request for Comment, Draft Regulation to Amend Regulation 62-104 respecting Take-Over Bids and Issuer Bids, and Draft Regulation to Amend Regulation 62-103 respecting Early Warning System and Related Take-Over Bid and Insider Reporting Issues, and Draft Amendments to Policy Statement 62-203 respecting Take-Over Bids and Issuer Bids (proposed Mar. 13, 2013), [hereinafter “Proposal”].
2 For more information about the Council of Institutional Investors (“CII”) and its members, please visit the CII’s Web site at [http://www.cii.org/about_us](http://www.cii.org/about_us). Of note, CII currently has three members that are based in Canada.
3 Proposal, Supra note 1, at 13.
4 Id. at 14.
5 Id. at 5.
6 Id.
7 Id. at 6.
market transparency and giving active investors an incentive to pursue turnaround situations at public companies. An unreasonably short disclosure requirement could have a chilling effect on active investors’ willingness to get involved in such campaigns, resulting in lost opportunities of value creation for both companies and their shareowners.8

II. Concerns Regarding Securities Lending

We are also concerned about the changes proposed regarding disclosure of securities lending arrangements.9 The proposed changes include redefining shares lent and borrowed as shares sold and acquired for the purposes of early warning disclosure and creating a limited exemption for certain lender disclosures for "specified securities lending arrangements."10 The CSA asserts that these increased disclosures would enhance the effectiveness of the early warning system.11

The Proposal highlights securities lending practices that allow for empty voting. Presumably the CSA believes that securities lending arrangements are being used by borrowers to buy cheap votes on issues of some material significance. The Proposal also highlights market transparency concerns relating to securities lending. For example, the Proposal states “we believe that increased transparency about these arrangements is appropriate so that the market can assess the use of these arrangements by the parties.”12 To achieve these twin aims, the Proposal includes disclosure of securities lending arrangements in its early warning reporting framework.

Our concerns here are twofold. First, we believe that the CSA should take a close look at all the matters relating to securities lending including the costs and benefits of implementing any changes and recent studies that have been published since the CSA took up this issue. Second, we believe the CSA should consider adopting the CII's policies regarding securities lending in order to enhance market transparency and efficiency.

A The CSA’s Securities Lending Proposals on the Basis of Empty Voting Abuses

We believe that the CSA should consider, if it has not already done so, reviewing and responding to recent comprehensive studies on securities lending before finalizing any changes here.13 In 2008, the CSA issued notice that it would be taking up this issue as a future initiative. It cited to a report that raised the specter of securities lending being

9 Proposal, Supra note 1, at 9
10 Id.
12 Proposal, Supra note 1, at 8.
abused by borrowers to acquire voting power. We recognize that the CSA has proposed these changes in response to certain industry stakeholder concerns that the securities lending market was being exploited for manipulative voting practices, but before any comprehensive study had been completed on the topic. With this newer information, the CSA might determine that its understanding of the costs and benefits of implementing the proposed securities lending changes needs to be reconsidered.

In 2008 when the CSA took up this issue, much of the fear regarding of securities lending abuses was based on a couple of specific incidents of securities lending abuse from foreign securities markets where such behavior may not be considered inappropriate. The most notable example was the case of MOL a Hungarian firm that could not legally vote its shares by law. MOL repurchased a portion of its outstanding shares and then lent the shares out to friendly banks willing to vote as directed by the firm. While the MOL fact pattern might be viewed as almost the exact opposite of traditional empty voting and would be permissible under the Proposal, the case is still cited as an example of securities lending abuse.

Further support for this belief is based upon the premise that increased equity lending near the time of the record date is caused by a market for votes. One of the earlier reports examining this issue, Vote Trading and Information Aggregation, was limited to examining the quantity and price of shares lent by one major U.S. shareholder from 1998 to 1999 and the number of shares lent in the U.K. The data indicated that there was an increase in securities lending activity near the record date. Based upon this limited data, the authors asserted that the increase of lending activity seen around the record date was “clear evidence” of there being an active market for votes. However, there are concerns by some reviewers of the study that this finding is dependent on “insufficient and non-representative data” not suitable for determining whether there is

---


17 Id. at 647.


19 Id. at 35.

20 See, Letter from the Center for the Study of Financial Market Evolution, to Security and Exchange Commission (Oct. 20, 2010), http://www.sec.gov/comments/s7-14-10/s71410-202.pdf. [hereinafter “CSFME Letter”]. (While not as comprehensive as the Aggarwal study, the RMA and CSFME study covered a much broader data set than previous studies on securities lending)
a significant problem in this area. Nevertheless, the conclusion echoed a concern that has proven to be popular and continues to have influence today.

Until 2010 there were no comprehensive studies on the matter to provide empirical data on this issue. In 2010, a comprehensive and detailed study of the U.S. securities lending market by professors from the McDonough School of Business at Georgetown University and the IESE School of Business at the University of Navarra became available, as well as a study conducted by the Risk Management Association (“RMA”) and the Center for the Study of Financial Market Evolution (“CSFME”).

The first study examined the U.S. securities lending market and proxy voting using proprietary data from 2005 through 2009. The study found that supply of securities available for loan around the record date is significantly restricted due to institutional shareholders retaining their shares for voting purposes. There was also a slight increase in demand during these periods, but that was found to be “economically small compared to the sharp reduction in supply.” The authors’ suggested that the slight increase in demand could indicate limited borrowing of shares for voting. However, the authors did not take into consideration the amount that lenders recalling shares increased borrowing demand as borrowers tried to supply recalled shares.

The second 2010 study by RMA and CSFME, though more limited in terms of data analyzed, reached a similar conclusion regarding securities lending and proxy voting. The study found “no strong evidence to conclude that securities lending programs have been used to any great extent to manipulate proxy votes or exercise undue influence on Corporate Governance issues.” The study also found that “broker borrowbacks” may also contribute to increased lending activity around a record date as brokers seek to make arrangements for recalled shares.

The CSA should consider, if it has not already done so, reviewing and responding to the above findings before implementing any changes to the current securities lending system. Such consideration might lead the CSA to determine that present securities lending issues are based less on borrowing for the purpose of empty voting and more on market transparency and informational asymmetries.

B. Securities Lending Proposals on the Basis of Enhancing Market Transparency

Apart from concerns over intentional empty voting abuses, the CSA includes as a basis for its securities lending proposals enhancing market transparency. We support market transparency in this area and believe that the CSA should take into consideration adopting amendments that would best achieve this end. We note that CII includes the following guidance in its membership approved Corporate Governance Policies:

21 Aggarwal, Supra note 13, at 4.
22 See Proposal, Supra note 1, at 4.
23 Aggarwal, Supra note 13, at 4.
24 CSFME Letter, Supra note 21, at 2.
25 Aggarwal, Supra note 13, at 34.
26 Id. at 35.
27 CSFME Letter, Supra note 21, at 2.
28 Id. at 22.
4.3 Record Date and Ballot Item Disclosure: To promote the ability of shareowners to make informed decisions regarding whether to recall loaned shares: (1) shareowner meeting record dates should be disclosed as far in advance of the record date as possible, and (2) proxy statements should be disclosed before the record date passes whenever possible.\(^{29}\)

We believe incorporating language from our policy in the Proposal might assist CSA in achieving their desired goal of “increasing transparency . . . so that the market can assess the use of these arrangements by the parties.”\(^{30}\) As the CSFME concluded, adopting this or a similar policy “would align voting rights for material ballot items to long-term investors and would therefore alleviate some concern over decoupling of voting and economic interests.”\(^{31}\) Most importantly, we are concerned that if the CSA does not adopt amendments consistent with our policy, the CSA’s proposed changes will not be effective in addressing its stated concerns regarding reducing empty voting and increasing market transparency because as proposed the changes do not give institutional lenders the tools that they need to control the votes of their shares on material items and more accurately price the securities loaned out. Therefore, we respectfully request that the CSA adopt amendments consistent with our policy before implementing the proposed changes and amendments.

We appreciate the opportunity to respond to the Proposal. If you should have any questions regarding this letter, please do not hesitate to contact me directly at 202.261.7088 or james@cii.org, or our General Counsel Jeff Mahoney at 202.261.7081 or jeff@cii.org.

Sincerely,

James Trotter

\(^{29}\) See Council of Institutional Investors, Corporate Governance Policies § 4.3 Record Date and Ballot Item Disclosure (last updated Apr. 19 2013), http://www.cii.org/corp_gov_policies#shareowner_meetings.

\(^{30}\) Proposal, Supra note 1, at 8.

\(^{31}\) CFSME Letter, Supra note 21, at 22.