5 Key Developments in Canadian Corporate Governance Rules in 2017

In 2017, Canadian legislators, regulators, and stock exchanges have implemented—or taken steps toward implementing—new rules and guidance in a number of areas relating to public company governance. As the year winds down, our Canadian Special Situations team reviews five key legal and regulatory developments in 2017, and what they mean for Canadian public companies.

Changes to corporate statutes

If CBCA and OBCA amendments pass, more issuers will be required to adopt majority voting, annual, individual election of directors, and diversity disclosure—if they have not already.

The past year has seen significant steps to amend both the Federal and Ontario corporate statues. If implemented, the main practical effect of the proposed amendments to the *Canada Business Corporations Act* (**CBCA**) and *Ontario Business Corporations Act* (**OBCA**) would be to require all Federal and Ontario public companies to adhere to majority voting, annual, individual elections for directors, and diversity disclosure, regardless of the exchange on which they are listed.

In doing so, the amendments would bring the CBCA and OBCA largely into line with existing requirements for TSX-listed companies. In addition, the amendments would fill certain perceived gaps in exchange requirements. The amendments would make these practices increasingly the norm, even where issuers may not be technically obliged to adopt them.

The Federal amendments, which were first introduced in September of 2016, are likely to pass in something close to their present form. They are now being considered in the Senate. However, the Ontario amendments, which were first introduced in March of 2017, are much less likely to pass, given that they were put forward in a private member's bill (though by a government MPP).

Both sets of amendments include:

- **Majority voting for directors:** Under Canadian corporate laws, shareholders can either vote for a director or "withhold" their vote. This means that directors can be elected by just one "for" vote, even if they receive more "withhold" votes. The amendments provide that public company directors can be elected in uncontested elections only if they receive a majority of "for" votes. This addresses the fact that under the TSX rules requiring a majority voting policy, directors who do not receive a majority of votes are only required to tender their resignation, with the board deciding whether to accept it. While resignations must be accepted absent "exceptional circumstances", in practice this provision has frequently resulted in defeated directors remaining on boards.

- **Annual, individual election of directors:** The amendments mandate that public company directors be elected annually and individually, largely mirroring existing requirements on the TSX and TSXV.

- **Mandatory diversity disclosure:** The amendments require that prescribed information with respect to diversity be given to shareholders. Under the CBCA regulations proposed in December 2016 to accompany the amendments, all public companies must disclose the number and proportion of directors and executive officers who are women. They also must disclose policies with respect to gender and other forms of diversity or explain why they have not adopted such policies.

In addition to these changes, the CBCA amendments allow CBCA public companies to take full advantage of notice-and-access by removing technical impediments.

The OBCA amendments include lowering the ownership threshold for shareholder proposals to nominate directors to shareholders collectively owning at least 3% of a company's shares, rather than the current 5% under the CBCA and OBCA. However, whereas the current OBCA provision allows a proposal to include "nominations for the election of directors", the amendments allow a proposal to nominate only a "single individual". The amendments also lower the threshold for requisitioning a meeting to shareholders collectively owning at least 3%, rather than the current 5% under the CBCA and OBCA. They also include allowing shareholders to make a proposal that a company adopt an executive compensation policy for officers and directors. If such a policy is adopted, the company would be required to set compensation in accordance with the policy.

Greater scrutiny for related-party transactions

Parties in related-party transactions will face more regulatory scrutiny of their process, especially with respect to fairness opinions.

On July 27, 2017, the Canadian Securities Administrators (the "**CSA**") published Multilateral CSA Staff Notice 61-302. The guidance advises that regulators in Ontario, Quebec, Alberta, Manitoba, and New Brunswick (**Staff**) will be reviewing related-party transactions covered by Multilateral Instrument 61-101 (**MI 61-101**) on a "real-time basis". It also provides clarity around the areas on which Staff will focus.

Overall, the guidance underscores the importance of ensuring a fair and rigorous process when undertaking a related-party transaction.

A few areas of the guidance are particularly noteworthy:

- While MI 61-101 requires special committees of independent directors only for insider bids, Staff now believe that they are advisable for all material conflict of interest transactions.
- Staff will expect meaningful and full discussion of the review and approval process, and have identified a number of common deficiencies, including:
  - inadequate disclosure of the context and background to a proposed transaction;
  - failure to provide a meaningful discussion of the board of directors' or special committee's process and their rationale for supporting a proposed transaction;
  - failure to provide disclosure of dissenting views of directors in respect of a transaction; and
  - overly one-sided disclosure regarding a recommended transaction that did not identify potential concerns or available alternatives.
- In the wake of the *InterOil* decision, Staff have raised their expectations for fairness opinions. When a fairness opinion is obtained, Staff now expect that issuers will:
  - disclose the compensation arrangement (though not necessarily the amount);

- disclose how the board and special committee took the compensation arrangement into account when considering the advisor's advice;
- disclose any other relationship between the financial advisor and the issuer or an interested party;
- provide a clear summary of the methodology, information and analysis underlying the opinion; and
- explain the relevance of the opinion to the board and special committee in deciding to recommend the deal.

Heightened expectations on diversity disclosure

Securities regulators are showing increased impatience at boilerplate or vague diversity disclosure.

CSA Multilateral Staff Notice 58-309—*Staff Review of Women on Boards and in Executive Officer Positions—Compliance with NI 58-101 Disclosure of Corporate Governance Practices* provides the CSA's third annual survey of compliance with National Instrument 58-101 and specifically, with its comply-or-explain diversity disclosure regime.

The review, released October 5 2017, notes that for the sample of 660 issuers reviewed this year, 14% of board seats were occupied by women, as against 11% 2 years ago. Similarly, the number of issuers surveyed with at least one woman on their board rose to 61%, from 49%. The review also notes that 26% of board vacancies in the sample were filled by women (a figure the CSA first reported this year).

Nonetheless, the CSA has noted that disclosure deficiencies continue in a number of areas, and reminds issuers that:

- Disclosure must include both the number and the percentage of women on an issuer's board of directors and in its executive officer positions.
- If a written policy regarding the representation of women on the board of directors has been adopted, a description of the policy and an explanation of how the policy applies to the identification of women directors, must be included.
- If gender targets have been adopted, disclosure of annual and cumulative progress in achieving those targets must be included.
- If there is consideration of the representation of women in the identification and selection of directorship and executive officer candidates, a description of the process must also be disclosed.
- If term limits or other mechanisms for the renewal of the board of directors have been adopted, a description of the limits and/or other renewal mechanisms as well as their contribution to board renewal, must be disclosed.

New continuous disclosure guidance for the internet and social media era

Securities regulators and exchanges are making clear that issuers must maintain consistent, high-quality disclosure regardless of the venue in which disclosure occurs. The TSX will also expect key governance documents to be placed on an issuer's website.

While social media and company websites may lack the formality of SEDAR, the same expectations around the quality and consistency of disclosure still apply. Overall, there is an emerging expectation that issuers present one face to the public—not different information in different venues—and that basic governance documents be accessible.

On March 9, 2017, the CSA published *Staff Notice 51-348*—*Staff's Review of Social Media Used by Reporting Issuers.* The CSA noted that 72% of the sample of 111 issuers reviewed were actively using at least one social media website.

In reviewing social media disclosure, the CSA identified a number of issues that will attract the CSA's scrutiny and potential corrective action, including:

- Selective disclosure on social media, including in the following respects:
  - Forward-looking information disclosed only on social media;
  - Lack of co-ordination about the timing of social media announcements; and
  - Third-party posts on social media which suggest missing continuous disclosure (ie. third parties are disclosing information that the issuer ought to have disclosed itself).
- Unbalanced or misleading disclosure on social media, including in the following respects:
  - Misleading or untrue statements, including statements inconsistent with information on SEDAR or that rely on non-GAAP figures; and
  - Analyst reports and other articles provided on social media (in contravention of the obligation to provide the names and/or recommendations of all independent analysts who cover the issuer, or to links that contain forward-looking information).

The CSA also highlighted the importance of having a social media governance policy covering matters such as, for instance, who can post, what can be posted, and who must approve the posts. The Ontario Securities Commission has also noted similar deficiencies in social media disclosure, and recommended a social media disclosure policy, in its Corporate Finance Branch Annual Report for 2016-2017.

In addition, amendments to the TSX Company Manual in October 2017 will require every TSX-listed issuer to put current versions of the following on its website effective April 1, 2018:

- its articles of incorporation, or any other constating or establishing documents and its by-laws; and
- if adopted, copies of its majority voting policy; advance notice policy; position descriptions for the chairman of the board and lead director; board mandate; and board committee charters.

New guidance on majority voting and advance notice policies

The TSX has tightened its guidance around majority voting policies and advance notice provisions, specifically criticizing a number of practices that some issuers have adopted which undermine the intentions behind such policies.

Since 2014, TSX issuers have been required to have majority voting policies. As discussed above, the intention of these policies is to enhance shareholder democracy by preventing directors being elected in uncontested elections without receiving a majority of votes cast.

Many issuers have also adopted advance notice provisions, which allow shareholders to nominate directors only if they give sufficient advance notice to the company. As with majority voting policies, advance notice provisions tend to enhance shareholder democracy, because they prevent shareholder ambushes which catch companies and their shareholders off-guard.

Nonetheless, over the past few years certain problematic practices have emerged. In TSX *Staff Notice 2017-0001*, issued March 9, 2017, the TSX identified a number of such practices. In its review of 200 majority voting policies, problematic features included:

- in effect not requiring a director to tender his or her resignation immediately if he or she was not elected by a majority of votes cast;

- not providing a time frame for the board of directors to render a decision as to whether or not to accept a resignation or a time frame outside the 90 day period permitted by the TSX;
- not specifically requiring the board of directors to accept the resignation of a director who was not elected by a majority of votes cast, absent exceptional circumstances;
- exceptional circumstances—that is, circumstances in which a director could refuse to resign—that were inconsistent with the policy objectives of the majority voting requirement (for instance, if a director is long-serving);
- not requiring the issuer to provide a copy of the news release with the board of directors' decision to the TSX; and
- additional requirements that may have the effect of circumventing the policy objectives of the majority voting requirement (such as elevated quorum requirements for director elections).

In its review of 25 advance notice policies, the TSX also identified a number of problematic features, including:

- Requiring the nominating security holder to be present at the meeting at which his or her nominee is standing for election for the nomination to be accepted, notwithstanding the number of votes obtained by such nominee;
- Requiring the nominating security holder to provide unduly burdensome or unnecessary disclosure (such as when the holding was acquired). However, the TSX does support disclosure of the nominating security holder's economic and voting position;
- Requiring the nominee or nominating security holder to complete a TSX Reporting Form 4 — Personal Information Form (or its equivalent) (the "PIF") for the nomination to be accepted, unless the PIF is also required by the issuer from management and board nominees; and
- Requiring the nominating security holder to complete a questionnaire, make representations, submit an agreement or provide a written consent in the form specified by the issuer, unless such questionnaire, representations, agreement or written consent is also required by the issuer from management and board nominees.

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Should you have any questions about what these policies mean for your company, please do not hesitate to contact a member of our Canadian Special Situations team:

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