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Legal update

New Canadian voting guidelines for 2016 proxy season

November 2015
Corporate finance and securities

Institutional Shareholder Services Inc. (ISS) and Glass Lewis have issued their Canadian proxy voting guidelines for the upcoming proxy season. The ISS Proxy Voting Guideline Updates are generally applicable to shareholder meetings of TSX and TSX-V issuers held on or after February 1, 2016.

This year ISS addresses the following key issues: director overboarding, externally managed issuers and equity compensation plans. The Glass Lewis 2016 Proxy Paper Guidelines address updates to director overboarding, audit committee overcommitment, nominating committee performance, director quorum requirements, exclusive forum provisions, proxy access, environmental and social risk oversight and dual-listed companies.

ISS and Glass Lewis recommendations can have a substantial effect on the outcome of shareholder meetings, particularly for issuers with a significant institutional investor shareholder base. Issuers are encouraged to review the ISS and Glass Lewis updates with their advisors and legal counsel to prevent any potential negative voting recommendations at their upcoming meetings.

ISS Updates

Overboarded Directors (TSX). ISS has changed its definition of overboarded to mean:

- for CEOs: sitting on more than 1 outside public company board (current recommendation is 2)
- for non-CEOs: sitting on more than 4 outside public company boards (current recommendation is 6)

ISS generally recommends withholding voting for a director of a TSX-listed company who is overboarded and whose attendance record at board and committee meetings is less than 75%. ISS will provide cautionary language in its reports where directors are overboarded, regardless of attendance. The new definition of overboarded will take effect in February 2017.

Externally Managed Issuers (EMIs) (TSX/TSX(V)). EMIs pay outside firms for management services and, in most cases, some or all of the executives are directly employed and compensated by the external management firm. ISS is concerned about board accountability where there is limited or insufficient disclosure on the management services agreement and executive compensation. ISS will look at EMIs on a case-by-case basis and make recommendations on say-on-pay resolutions and director nominations after considering the following factors:

- the size and scope of the management services agreement;
- executive compensation in comparison to peers and/or similarly structured issuers;
- overall performance;
- related party transactions;
- board and committee independence;
- conflicts of interest and process for managing conflicts effectively;

- disclosure and independence of the decision-making process for selection of the management services provider;
- risk-mitigating factors included in the agreement such as fee recoupment mechanisms;
- historical compensation concerns;
- executives' responsibilities; and
- other factors appropriate to assess the issuer's governance framework.

Equity Compensation Plans (TSX). ISS will continue to make recommendations regarding equity compensation plans on a case-by-case basis, but is adopting an equity plan "scorecard" similar to the one introduced last year in the US. The new factors that will be considered in the scorecard, both positive and negative, fall under three categories:

- Plan Cost:
  - The total estimated cost of the company's equity plans relative to industry and market cap peers, measured by the company's "Shareholder Value Transfer" (SVT) in relation to its peers and considering both:
    - SVT based on total new and previously reserved plan shares plus outstanding grants and awards, and
    - SVT based only on the new shares request plus shares previously reserved but not granted.

- Plan Features:
  - absence of problematic change-in-control provisions (such as single-trigger acceleration of award vesting and settlement of performance-based equity at target or above regardless of performance);
  - no financial assistance to plan participants for the exercise or settlement of awards;
  - public disclosure of the full text of the plan document; and
  - reasonable share dilution from equity plans relative to market best practices.

- Grant Practices
  - reasonable three-year average burn rate relative to market best practices;
  - meaningful time vesting requirements for the CEO's most recent grants (3-year look-back);
  - the issuance of performance-based equity to the CEO;
  - a clawback provision applicable to equity awards; and
  - post-exercise / post-settlement share-holding requirements (S&P/TSX Composite Index only).

The scorecard model will use two index groups to determine the thresholds and factor weightings: S&P/TSX Composite Index and Non-Composite TSX-listed issuers.

ISS will recommend generally voting against a plan proposal if its overall score indicates that the plan is not in shareholders' interests. In addition to the scorecard approach, ISS will recommend voting against a plan if any of the following unacceptable factors have been identified.

- discretionary or insufficiently limited non-employee director participation;
- inadequate restrictions on the ability to amend the plan without shareholder approval;
- a history of repricing stock options without shareholder approval (3-year look-back);
- problematic pay practices or a significant pay-for-performance disconnect; and
- any provisions that have a significant impact on the interests of shareholders.

Glass Lewis Updates

Overboarded Directors (TSX). Glass Lewis has amended its definition of "overboarded" to mean:

- for executive officers: sitting on more than 1 outside public company boards (current recommendation is 2)
- for non-executive officers: sitting on more than 4 outside public company boards (current recommendation is 5).

Glass Lewis generally recommends withholding voting for a director of a TSX-listed company who is overboarded. The new definition of overboarded will result in a note of concern for meetings held in 2016 and a withhold vote for meetings held in 2017.

Glass Lewis generally permits directors of TSXV-listed companies to sit on up to 9 boards.

Audit Committee Overcommitment (TSXV). Glass Lewis is introducing a more lenient standard in determining whether audit committee members of TSXV-listed issuers are over-committed by virtue of sitting on multiple public company audit committees. Generally a director who sits on 4 audit committees (3 for TSX-listed companies), or, if he or she has financial expertise, 5 audit committees (4 for TSX-listed companies) will be considered overcommitted. Factors that will be considered include the size of the companies, their geographical distribution and the director's expertise and commitments.

Nominating Committee Performance. Glass Lewis may recommend withholding a vote for the chair of the nominating committee where the board has failed to ensure that it has directors with relevant experience, either through board assessment or refreshment, which has contributed to a company's poor performance.

Director Quorum Requirements. When assessing the adoption of, or amendments to, a company's charter or by-laws, Glass Lewis will look for a requisite quorum of a majority of the directors of the board to ensure broad representation.

Exclusive Forum Provisions. Glass Lewis will generally recommend voting against any by-law or charter amendment seeking to adopt an exclusive forum provision, as limiting shareholders' legal venue may not be in the shareholders' best interest. They may however support such a provision if the company:

- presents a compelling argument on why the provision would directly benefit shareholders;
- provides evidence of abuse of legal process in other non-favoured jurisdictions; and
- has a strong record of good corporate governance practices.

Proxy Access. Proxy access would allow certain shareholders to nominate directors to the board and have them included on the company's ballot. The following factors will be considered on a case-by-case basis when evaluating whether to support a company's proposal to implement a shareholder request for proxy access:

- company size;
- board independence and diversity of skills, experience, background and tenure;
- the shareholder proponent and the rationale for making the proposal at the target company;
- the percentage ownership requested and the holding period requirement;
- shareholder base in both percentage of ownership and type of shareholder (e.g., hedge fund, activist investor, mutual fund, pension fund, etc.);
- responsiveness of board and management to shareholders, evidenced by progressive shareholder rights policies (e.g., majority voting, declassifying boards, etc.) and reaction to shareholder proposals;
- company performance and steps taken to improve poor performance;
- existence of anti-takeover protections or other entrenchment devices; and
- opportunities for shareholder action (e.g., ability to act by written consent or call a special meeting).

Environmental and Social Risk Oversight. Glass Lewis will recommend withholding a vote for directors responsible for risk oversight in cases where the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively impact shareholder value.

Dual-Listed Companies. In considering proposals by companies whose shares trade on exchanges in multiple countries, Glass Lewis will consider a number of factors in determining which Glass Lewis country-specific policy to apply.

Copies of the guidelines can be accessed below.

ISS Canada Proxy Voting Guideline Updates

Glass Lewis 2016 Proxy Paper Guidelines

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