Legal update

Proxy season 2020: ISS and Glass Lewis update guidance

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Corporate Governance
Corporate M&A and Securities

Institutional Shareholder Services (ISS) and Glass Lewis (GL) have updated their proxy voting guidelines for the 2020 proxy season. Changes to the guidelines include director meeting attendance and committee meeting disclosure, director overboarding, board diversity, ratification of auditors and excessive non-audit fees, policies applicable to majority-owned/controlled companies, and executive compensation and contractual payments and arrangements. Unless otherwise noted, the revised guidelines are generally applicable to meetings held in 2020.¹

Director attendance and committee meeting disclosure

ISS and GL clarified their policies regarding directors’ attendance records and disclosure regarding audit committee meetings.

**ISS**
- ISS clarified that when evaluating director attendance for TSX-listed companies, exceptions will be made for nominees who served for only part of the fiscal year or as directors of newly publicly listed companies or companies that have recently graduated to the TSX, on a case-by-case basis.
- ISS will withhold voting for individual director nominees for TSX-listed companies if a company:
  - has not adopted a majority voting director resignation policy and the individual director has attended less than 75% of the director’s board and key committee (audit, compensation and nominating) meetings in the last year (without reason); or

**Glass Lewis**
- GL will generally recommend voting against the governance committee chair of TSX-listed companies when records for board and committee meeting attendance are not disclosed.
- Beginning in 2021, GL will recommend voting against:
  - the governance committee chair of TSX issuers when the number of audit committee meetings that took place during the most recent year is not disclosed; and
  - the audit committee chair if the audit committee did not meet at least four times during the year.
• has adopted such a policy and an individual director has attended less than 75% of such meetings and a pattern of low attendance exists based on prior years’ meeting attendance.

• ISS emphasizes that its 75% attendance threshold is calculated on the aggregate of a director’s board and key committee meetings attendance.

**Director overboarding**

The issue of director overboarding and whether a director can effectively discharge his or her duties when serving on multiple boards continues to draw the attention of institutional shareholder groups.

**ISS**

• ISS will continue in 2020 to recommend to withhold voting for “overboarded” directors of TSX-listed companies.

• ISS recognizes it is preferable if a director steps down from a board at an annual meeting to ensure an orderly transition and that this may cause a director to be temporarily overboarded (e.g., where a director joins a new board in March but is stepping off another board in June). ISS has indicated that it will:
  
  • generally not count a board when it is publicly disclosed that the director will be stepping off that board at the next annual meeting. This disclosure must be included within the company’s proxy circular to be taken into consideration; and

  • include the new boards that a director is joining even if the shareholder meeting with the nominee’s election has not yet taken place.

• As a reminder:
  
  • a non-CEO director who serves on more than five public company boards will continue to be considered overboarded;

  • a CEO director who sits on more than two outside public company boards will continue to be considered overboarded and ISS will recommend withholding votes for CEO director in respect of

**Glass Lewis**

• GL will continue to generally vote against an “overboarded” director, meaning a director:

  • who is an executive officer who sits on more than two outside public company boards; or

  • is a non-executive board member who sits on more than five public company boards.

• GL generally permits TSX-V directors to sit on up to nine boards. Where directors are on both TSX and TSX-V boards, GL will consider on a case-by-case basis. GL will look at specific duties and responsibilities of the executive in determining if an exemption is warranted.
election to outside boards; and

- subsidiary boards will be counted as separate boards. However, ISS will not recommend withholding voting for a CEO director of any controlled subsidiary (>50% ownership).

Board diversity

The Canadian Securities Administrators require TSX-listed issuers to disclose whether they have adopted a written policy on nominating women directors and executive officers and, if so, how the board or its nominating committee measures the effectiveness of such policy. If no policy has been adopted, issuers must disclose why not.

Amendments to the Canada Business Corporations Act (CBCA) will come into force on January 1, 2020. These amendments impose new disclosure obligations regarding diversity of directors and senior management on all CBCA distributing corporations. These new disclosure obligations are not restricted to gender but impose a broader standard of diversity and apply to TSX, TSX-V and CSE issuers.

Notwithstanding the existing disclosure obligations under securities law and the impending introduction of obligations under federal corporate law, ISS and GL have not changed their diversity guidance to incorporate these broader standards.

**ISS**

- ISS has not changed its 2019 gender diversity guideline, which is applicable in the 2019 proxy season to “widely held” companies (defined as S&P/TSX Composite Index companies as well as companies designated by ISS based on ISS client ownership).

**Glass Lewis**

- GL will review any new company diversity disclosure resulting from the CBCA amendments and, where relevant, reflect such expanded disclosure in its analysis for the election of directors at TSX-listed issuers.

- GL’s 2019 guidance on diversity disclosure has not changed.

Ratification of auditors and excessive non-audit fees

This year, both ISS and GL made changes to their policies regarding excessive non-audit fees.

**ISS (TSX and TSX-V)**

- In considering whether to ratify an external auditor, ISS determines whether the “non-audit fees” paid to the auditor exceed the audit and related fees and tax compliance and preparation fees.

- In determining excessive non-audit fees, ISS previously limited carve-outs from the “non-audit fees (other)” category, considering only IPOs, emergence from bankruptcies and spin-offs.

**Glass Lewis**

- GL codified its policy on non-audit fees, stating it may recommend voting against all audit committee members in the second successive year of excess non-audit fees.
ISS’s updated 2020 guidance indicates that:

- it may also carve out fees related to M&A transactions, including dispositions. For companies in the business of regularly acquiring/disposing assets, however, their M&A transactions may not be deemed as eligible for a carve-out; and

- fees connected to re-domiciliation may also qualify as a one-time fee eligible to be carved out.

- There is otherwise no change to the ISS disclosure requirement: fees related to all one-time capital structure events will be eligible to be carved out only if there is adequate disclosure about the transactions and a clear breakdown of fees.
Policies applicable to majority owned / controlled companies

Both GL and ISS updated their policies applicable to both TSX- and TSX-V-controlled or majority-owned companies.

**ISS (TSX and TSX-V)**
- ISS supports a one-share, one-vote principle.
- ISS clarifies that its policy of supporting director nominees (on a case-by-case basis) who are or who represent a controlling shareholder of a majority owned company:
  - applies only to non-management director nominees; and
  - will not apply if any of the independence and governance criteria set out in the policy are not met.

**Glass Lewis**
- GL expanded its policy on independence standards for controlled companies, providing that controlled companies are not required to meet GL’s minimum board size threshold (five directors for TSX issuers and four directors for TSX-V issuers).

Executive compensation; contractual payments and arrangements

In their 2020 guidelines, ISS and GL continued to refine their policies regarding executive compensation and contractual payments and arrangements.

**ISS**
- ISS continues to vote on a case-by-case basis on TSX-V issuers’ share-based compensation plans.
- ISS provides new guidance regarding rolling plans. ISS will generally vote against an equity compensation plan if the plan is a rolling equity plan that enables auto-replenishment of share reserves without requiring periodic shareholder approval at least every three years (i.e., an evergreen plan).
- ISS issued new guidance that, for meetings on or after February 1, 2021, ISS will generally vote withhold for the continuing compensation committee members (or in cases where compensation committee members have not been identified and the entire board fulfills the role of compensation committee, vote withhold for the board chair), if the company (i) maintains an evergreen plan, (ii) has not sought shareholder approval in the past two years and (iii) does not seek shareholder approval of the plan at the meeting.

**Glass Lewis**
- GL clarified that it expects comprehensive disclosure regarding mid-year adjustments to short-term incentive plans. Where management has received a short-term bonus where goals were lowered mid-year or calculated payouts were increased, GL will expect a robust discussion of why the decision was necessary.
- GL clarified its approach to analyzing both ongoing and new contractual payments and executive entitlements/arrangements. In general, GL disfavours contractual agreements that are excessively restrictive in favour of the executive. In its 2019 guidance, GL identified inadequately explained or excessive sign-on arrangements and guaranteed multi-year bonuses as factors that may support a negative voting recommendation. In its 2020 guidance, GL added as problematic factors: (i) excessive severance payments, (ii) new or renewed single-trigger change-in-control arrangements, and (iii) a failure to remedy problematic provisions in a revised or renewed contractual arrangement.
Other changes / guidance

**ISS**

- **Former CEO/CFO on Audit/Compensation Committee:** ISS will continue to recommend withholding votes from any audit or compensation committee member of a TSX-listed company who has served as CEO of the company or its affiliates within the past five years, or as CEO of a company acquired within the past five years, and is a member of the audit or compensation committee. ISS will continue to evaluate on a case-by-case basis whether support is warranted for any former CEO on the audit or compensation committee following a five-year period after leaving as a CEO. ISS will generally recommend withholding votes for any director who has served as the CFO of a TSX-listed company and/or its affiliates within the past three years, or of a company acquired within the past three years, and is a member of the audit or compensation committee.

**Glass Lewis**

- **Board Skills:** GL announced in 2019 that it was codifying its assessment of board skills as an integral part of the analysis of proposals to elect directors. In its 2020 guidance, GL clarified its expectation that companies provide meaningful disclosure in line with developing best practice standards. Issuers are encouraged to refer to GL’s Board Skills Appendix for an overview of the skills that GL considers in relation to certain key industry sectors in its analysis of director elections at large-cap TSX issuers; we note there were no changes to GL’s Board Skills Matrices from 2019.

- **Say-on-Pay:**
  - GL bolstered its description of focus areas of its review of say-on-pay proposals, by adding the following areas: (i) the selection and challenging nature of performance metrics, and (ii) the implementation and effectiveness of the company’s executive compensation programs, including pay mix and use of performance metrics in determining pay levels.
  
  - GL clarified that its review of significant changes and modifications will involve consideration of post-fiscal year-end changes and one-time awards, particularly where changes touch upon issues that are material to GL recommendations.

- **Company Responsiveness to Say-on-Pay Proposals:** GL expanded its discussion of what it considers to be an appropriate response following low shareholder support for a say-on-pay proposal at the previous annual meeting (i.e., where 20% or more of shareholders opposed management’s proposal), including different levels of responsiveness depending on the severity and persistence of shareholder opposition. GL expects
a robust disclosure of engagement activities and specific changes (to a company’s compensation program) made in response to shareholder feedback. Absent such disclosure, GL may consider recommending against an upcoming say-on-pay proposal.

- **Pay for Performance:** GL clarified that its measurement of the compensation and performance of an issuer against a peer group of appropriate companies will involve both quantitative and qualitative analyses.

Depending on their institutional shareholder base, issuers will also want to consider the voting recommendations issued by other institutional shareholders that may, in some instances, exceed the ISS and GL guidelines. Copies of the ISS 2020 Americas Proxy Voting Guidelines updates can be accessed [here](#) and the GL 2020 Proxy Paper Guidelines Recommendations (Canada) can be accessed [here](#).

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**Footnote**

1 The ISS guidelines are effective for meetings held on or after February 1, 2020, and the GL guidelines are effective for meetings held on or after January 1, 2020.

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