ISS & Glass Lewis Release 2018 Proxy Guideline Updates (Canada & U.S.)

HUGESSEN CONSULTING

Client Alert

Institutional Shareholders Services ("ISS") and Glass Lewis ("GL") recently released updates to their 2018 voting guidelines for Canada and the U.S. The updated guidelines from ISS will apply to shareholder meetings for publicly-traded companies on or after February 1, 2018, while those from Glass Lewis will apply to meetings held on or after January 1, 2018. This memo provides a summary of policy updates on compensation-related and board-related topics in both jurisdictions. Overall, the 2018 updates were less extensive than in previous years, with the Canadian updates focusing more so on board governance practices (e.g. board gender diversity, director overboarding), than compensation-related guidelines.

Key Policy Highlights

- ISS and Glass Lewis both introduced policies in Canada on board gender diversity whereby the proxy advisors will generally recommend withhold / against votes for the Chair of the Nominating Committee at companies with no disclosed gender diversity policy / rationale and no female directors serving on the board.
    - ISS' policy will apply in 2018 for S&P/TSX Composite Index companies, while GL's will apply in 2019.
- ISS aligned its Canadian director "overboarding" policy with its U.S. policy and Glass Lewis' guidelines. Beginning in 2019, ISS will remove the 75% attendance requirement from its assessment while increasing its threshold to no more than 5 public-company boards for non-CEO director nominees and 2 outside boards for active CEOs.
- Beginning in 2019 at both Canadian and U.S. issuers, Glass Lewis will generally recommend voting against members of the Governance Committee at companies that plan on holding a virtual-only annual general meeting and do not provide robust proxy disclosure of rationale.
- ISS is introducing a new U.S. policy whereby they will vote against board/committee members responsible for approving/setting NED compensation where there is a recurring pattern (two+ consecutive years) of excessive Non-Executive Director ("NED") pay without a compelling rationale or other mitigating factors.
    - This follows the introduction of a CND ISS policy in 2017 whereby ISS recommends against directors responsible for setting pay where the compensation practiced is viewed to pose independence risk (e.g., appointment grants)

Canada: 2018 Compensation-Related Policy Updates

ISS: Pay-for-Performance Evaluation

- Methodology for the Relative Degree of Alignment test will now include the rankings of CEO total pay and company financial performance within a peer group, each measured over a three-year period.

Royal Bank Plaza, South Tower | Suite 3200, PO Box 155, 200 Bay Street | Toronto, ON M5J 2J4
T +1.416.868.1288 F +1.416.868.4415 W hugessen.com

Canada: 2018 Board-Related Policy Updates

Board Gender Diversity

- **ISS:** ISS is introducing a new policy, applicable to S&P/TSX Composite Index companies in 2018 and to non-Composite Index issuers in 2019, which will generally lead to a withhold vote recommendation for the Chair of the Nominating Committee (or Chair of the Board if there is no Nominating Committee) if a company:
    1. Has not adopted a formal written gender diversity policy
        - ISS will be looking for a robust policy that includes measurable goals / targets, and will consider the board's approach to gender diversity in executive officer positions as well
    2. Does not have any female directors serving on its board.
- **Glass Lewis:** For 2018, diversity will be one of many considerations when evaluating companies' oversight structures.
    - Beginning in 2019, GL will recommend voting against the Chair of the Nominating Committee (and potentially the entire Nominating Committee) of a board with no female members, or that has not adopted a formal written gender diversity policy.
- **Implication:** Given gender policy disclosure is mandated by Canadian Securities regulators, most companies should already have begun disclosing formal policies in 2017. ISS' one-year grace period for smaller TSX-listed companies and Glass Lewis' period for all issuers is intended to provide time to adopt meaningful policies and make necessary board changes.

Director Overboarding

- **ISS:** beginning in 2019, ISS will consider a director overboarded and generally recommend a withhold vote if he/she:
    - Serves on more than 5 public-company boards for non-CEO director nominees and 2 outside boards for active CEOs (up from 4 and 1)
    - While a CEO's subsidiary boards will be counted as separate boards, a withhold vote will not be recommended for the CEO of a parent company board or any of the controlled (>50% ownership) subsidiaries of that parent.

    However, attendance (previously 75% requirement) will no longer be a factor in the analysis.
- Glass Lewis did not adjust their policy, which is now aligned with ISS' (director serves on more than 5 public-company boards and 2 boards for active CEOs), but clarified their approach when evaluating outside commitments of non-CEO executive roles (e.g. Executive Chair):
    - GL will evaluate specific duties and responsibilities of the executive role or the director's time commitments, when determining whether to apply the 2-board limit.
- **Implication**: By 2019, both proxy advisors will recommend against the election of directors who exceed the thresholds on board commitment. However, both ISS and Glass Lewis, in making their recommendation, may consider any disclosed rationale for continued service on the board.

Glass Lewis: Dual-Class Share Structures When evaluating corporate governance practices following an IPO or spin-off, Glass Lewis will now include the presence of a dual-class share structure as an additional factor in determining whether shareholder rights are being severely restricted.

- This is intended to support GL's view that dual-class structures are not in the best interests of common shareholders and generally reflect negatively on a company's overall corporate governance.

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Glass Lewis: Board Responsiveness

- GL clarified that any time 20% or more of shareholders vote contrary to the recommendation of management (including director elections and shareholder proposals), the board should demonstrate some level of engagement and responsiveness to address the shareholder concerns.
    - When GL is evaluating whether board responsiveness to shareholder votes is warranted in dual-class share structures situations, it will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders.

Glass Lewis: Virtual AGMs

- Where a company is holding a virtual-only meeting, GL will look for robust disclosure assuring shareholders they will have the same rights and opportunities to participate as they would at an in-person meeting.
    - Beginning in 2019, GL will generally recommend voting against members of the Governance Committee at companies that plan on holding a virtual-only annual general meeting and do not provide such disclosure.

Glass Lewis: Proxy Access

- Clarified that proxy access-related shareholder proposals at non-U.S.-based companies will continue to be evaluated on a case-by-case basis in the context of the regulatory landscape within the specific country in question.

U.S.: 2018 Compensation-Related Policy Updates

ISS: Gender Pay Equity (Shareholder Proposals)

- ISS is introducing a new policy to address shareholder proposals related to gender pay equity.
    - Proposals requesting gender pay data or company policies and goals will be evaluated on a case-by-cases basis based on the company's current policies and disclosures (in general and relative to its peers), the company's compensation philosophy and equitable pay practices, and whether the company has been subject to recent controversies, litigation or regulatory action related to gender pay gap issues.

Glass Lewis: CEO Pay Ratio

- While GL will display the pay ratio as a data point in its Proxy Papers, it will not be a determinative factor in its voting recommendations.

U.S.: 2018 Board-Related Policy Updates

ISS: Director Elections and Poison Pills

- ISS updated its policy regarding poison pills so that it will recommend against all board nominees, every year, at a company that maintains a long-term poison pill that has not been approved by shareholders (versus every three years previously for annually elected directors).
    - Short-term poison pills will continue to be assessed on a case-by-case basis, with the updated policy focusing more so on rationale for their adoption versus the company's governance track record.

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Glass Lewis: Board Gender Diversity

- Beginning in 2019, GL will generally recommend voting against the Chair of the Nominating Committee (and potentially the entire Nominating Committee) of a board with no female members.
    - GL will consider both proxy disclosure of its diversity considerations (i.e. rationale for not having any female board members, or a plan to address the lack of diversity on the board) and whether the company is within the Russell 300 Index (more leniency granted if outside the Index).

ISS: Non-Employee Director Pay

- ISS is introducing a new policy whereby they will vote against board/committee members responsible for approving/setting NED compensation where there is a recurring pattern (two or more consecutive years) of excessive NED pay without a compelling rationale or other mitigating factors.
    - The new policy will not impact 2018 recommendations.

ISS: Similar update to the Pay-for Performance Evaluation as made to the Canadian guideline

Glass Lewis: Similar updates to Dual-Class Share Structures, Board Responsiveness and Virtual AGMs as made to the Canadian guidelines

Concluding Thoughts

Proxy advisor recommendations are widely believed to have a material impact on the voting results at shareholder meetings. Issuers will need to be mindful of the policy updates from ISS and Glass Lewis and be aware of the potential implications of these policies. Having said that, based on Hugessen's experience, there is an increasing willingness, particularly among institutional shareholders, to assess company compensation programs on a nuanced case-by-case basis. This further underscores the importance of providing clear, transparent disclosure and maintaining open communication with shareholders.

To learn more, please contact:

Michelle Tan, Principal	416-868-4421	mtan@hugessen.com
Erin Poeta, Manager	403-441-6294	epoeta@hugessen.com

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