ISS and Glass Lewis Release 2015 Updates to Canadian Compensation Voting Guidelines

The Highlights

- Proxy advisory firms Institutional Shareholders Services ("ISS") and Glass Lewis ("GL") recently released updates to their 2015 voting guidelines
- ISS has not changed existing or adopted any new compensation-related policies
- GL has made two compensation-related changes: i) clarified an enhanced policy regarding one-time equity grants, and ii) expanded the list of considerations that may mitigate an 'against' vote recommendation when a company fails their pay-for-performance ("P4P") test
- Both ISS and GL have amended policies related to director elections

What it Means

The relatively small number of compensation policy updates which introduce additional considerations to augment existing "bright line tests" are in line with our recent discussions with institutional shareholders. There appears to be (to varying degrees), an increasing willingness to evaluate an issuer's compensation programs on a more nuanced case-by-case basis versus the proxy advisor's "check the box" approach.

For issuers to benefit from these changes, shareholders will expect more in terms of the disclosure and communication provided by companies and boards, so they can understand and evaluate the program and the decision being made by directors. In fact, an increasing number of institutional shareholders are developing their own customized proxy guidelines and expanding in-house expertise.

This suggests that the type of information shareholders are relying on from proxy advisors, and how they use it, is evolving. There appears to be a gradual shift away from the reliance on prescriptive and "bright line tests" applied by the proxy advisors to closer scrutiny of an issuer's disclosure of pay decisions and rationale and the linkage to performance. The limited changes / new policies promulgated by the proxy advisors for 2015 is at least in part a reflection of this change in demand from their clients, the shareholders.

While boards should be aware of the proxy advisor guidelines given the significant influence they continue to have on the shareholder vote, we would encourage directors to engage with their shareholders to understand their unique priorities and expectations with respect to executive pay and pay-for-performance, and as appropriate, be responsive to these areas in disclosure and communications.

To learn more, please contact:

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Glass Lewis Compensation Policy Updates for Canada

Below is a summary of GL policy updates related to compensation.

1) *Pay and Performance*

   Key Change:

   Expanded list of areas assessed under the criteria for determining its say-on-pay ("SOP") recommendation when a company has received a 'failing grade' on the quantitative P4P test, including, "an effective overall incentive structure, significant forthcoming enhancements or reasonable long-term payout levels".

   Implications:

   In its inaugural year, GL' quantitative P4P test appeared to drive a significant number of SOP vote recommendations against management. The broader qualitative review that GL will apply implies a more open and holistic approach when evaluating compensation programs. The additional criteria does not reduce the importance of the alignment between pay and performance, but acknowledges the context in which incentive programs exist.

2) *One-Off Awards*

   Key Changes:

   One-time incentive grants outside of regular annual grants are generally not supported in principle, but will be assessed case-by-case on the basis of; grant terms, size, any future service or performance conditions, and the rationale for why one-time awards are needed in addition to the regular compensation program. GL prefers to see existing compensation programs redesigned if they fail to provide adequate incentives.

   Implications:

   Directors considering one-time awards may want to also look at draft disclosure to be included in the CD&A if such awards are approved. Transparent, thoughtful disclosure of the board's rationale will be a key to gaining shareholder support.

Other Key Policy Updates for Canada

- Director performance (GL)
  - Enhanced guidance in respect of directors who have served on boards or as executives of companies with "indicators of mismanagement or actions against the interests of shareholders" (i.e., records of poor performance, inadequate risk oversight, excessive compensation, audit- or accounting-related issues)
  - Directors who are deemed to have exhibited a pattern of poor oversight (at a single board or across different companies for the same issue) will be re-evaluated on a number of facets including; severity and time since the issue, shareholder support, and tenure, etc

- Board evaluation and renewal (GL)
  - Emphasizes on more rigorous board evaluation processes when assessing board composition, rather than arbitrarily mandating director rotation using director term/age limits
  - However, where term/age limit policies have been adopted they should not be waived

- Director Majority voting policy (GL)
  - Following the new TSX rule, companies listed on the TSX will be expected to have a majority voting policy (the exemption for controlled companies remains)

- Definition of director independence (ISS)
  - Introduction of a five-year "cool off" period for former CEOs remaining as a director of the board, after which they may be considered independent
  - Change moves the ISS definition closer to that of the Canadian Securities Administrators', (i.e. 3-year "cooling off" period) although differences still exist

- Shareholder rights and anti-takeover devices
  - Multiple technical updates in regards to; shareholder rights plans (ISS & GL), article/bylaw amendments (ISS), private placements (ISS), and advance notice policies (ISS & GL)
  - ISS has also adopted a new policy to recommend withholding from individual directors if an advance notice policy is put in place without shareholder approval

GL' new policies will become effective for meetings dated January 1, 2015, while ISS policy updates are effective for meetings commencing on February 1, 2015.

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