ISS and Glass Lewis Release 2016 Canadian Proxy Guideline Updates

Institutional Shareholders Services ("ISS") and Glass Lewis ("GL") recently released updates to their 2016 voting guidelines for Canada. ISS updates will apply to shareholder meetings for publicly traded Canadian companies on or after February 1, 2016. GL updates will apply to meetings held on or after January 1, 2016.

Key Policy Highlights

- ISS made two compensation-related changes:
  - Adopted a more robust approach to assess equity-based incentive plans using a balanced scorecard based on plan cost, plan features, and granting practices
  - Adopted a new policy on Externally Managed Issuers ("EMIs")
- GL has not changed existing or adopted any new compensation-related policies
- Both ISS and GL have tightened director overboarding definitions
- GL adopted a number of other policies focused on director accountability and performance

What it all Means

ISS' adoption of the Equity Plan Scorecard in Canada one year after it was rolled out for the U.S. market is a significant enhancement to the advisor's approach to assessing equity incentive plans. Hugessen believes that the inclusion of plan features and granting practices – beyond just plan cost, is overall a positive development for both issuers and investors. However, the implication of this policy will depend on the overall governance of a company's equity plan.

The majority of the 2016 GL updates address the evolving role and accountabilities of directors, recognizing the rising expectations placed on board members. Companies will find shareholders and their advisors scrutinizing board composition and director performance more than ever.

Proxy advisor recommendations are widely believed to have a material impact on the outcome of shareholder meetings. From Hugessen's conversations with several institutional shareholders, there is an increased willingness to evaluate an issuer's compensation programs on a more nuanced case-by-case basis. This emerging trend underscores the importance of transparent disclosure and open communication with shareholders.

A high-level summary of all 2016 policy updates is provided below.

2016 ISS Compensation-Related Policy Updates for Canada

Equity Plan Scorecard (EPSC) (TSX)

- **Key change:** ISS' current approach for evaluating equity proposals (series of pass/fail tests with a focus on plan cost) will be replaced with a more comprehensive Equity Plan Scorecard ("EPSC").

The EPSC will assess equity plans based on three categories of factors: plan cost, plan features, and grant practices.

- Plans may nevertheless receive a recommendation against for overriding negative plan features including:
  - Problematic non-employee director participation
  - Insufficient plan amendment provisions
  - Repricing without shareholder approval
  - Other egregious practices
- **Rationale:** ISS' previous approach did not consider qualitative features of equity plans beyond the Shareholder Value Transfer cost.
- **Implication:** Companies with an equity plan on their 2016 proxy ballot will want to review the overall structure and disclosure of their equity plans, including the considerations outlined in the EPSC. Note: additional information about the policy and weightings of each factor will be included in ISS' Canadian FAQs released later in December.

Externally Managed Issuers (TSX and TSXV)

- **New Policy:** ISS will vote on a case-by-case basis on say-on-pay ("SoP"), individual directors, committee members, or the entire boards of an Externally Managed Issuers ("EMIs") that provide insufficient disclosure about its management services agreement and how senior management is compensated. Among other factors, compensation at EMIs will be assessed on:
  - Size and scope of the management services agreement
  - Overall performance
  - Related party transactions
  - Independence of the board and committee
  - Conflicts of interest and process for managing conflicts
  - Historical compensation concerns
- **Rationale:** EMIs are not required and do not generally disclose the details of the management agreement. Disclosure is often limited to the aggregate fee paid to the external manager.
- **Implication:** Boards of EMIs may wish to enhance the disclosure of external management compensation to avoid negative SoP and director recommendations.

2016 Board-Related Updates for Canada

Overboarding (TSX)

- Both ISS and GL have tightened how they define an "overboarded" director, with each advisor providing a one-year grace period before implementing their new thresholds
- ISS' will consider the following directors overboarded:
  - Non-CEO directors who serve on more than four public company boards (down from six)
  - CEOs who serve on more than one external public company board (down from two)
  - ISS' policy remains double-triggered (i.e., negative recommendations only where directors are overboarded *and* have low attendance)
- GL will consider the following directors overboarded:
  - Non-CEO directors who serve on more than five public company boards (down from six)
  - CEOs who serves on more than two public company boards (down from three)

    - Directors on TSX Venture boards will continue to be subject to a more lenient (albeit undisclosed) standard

Nominating Committee Performance (TSX and TSXV)

- GL clarified that it may recommend against chair of the nominating committee if inadequate relevant experience among board members has contributed to poor company performance.

Director Quorum requirements (TSX and TSXV)

- GL has supplemented its guidelines for director meeting quorum to ensure quorum is high enough for sufficient broad representation but low enough to transact business. GL expects quorum for meetings of directors to be a majority of the directors on the board.

Environmental and social risk oversight (TSX and TSXV)

- GL will recommend against directors who fail to identify and mitigate material environmental or social risk that negatively impacts shareholder value.

Audit Committee Over-Commitment (TSXV)

- GL will relax the limits placed on audit committee members among TSX Venture issuers on a case-by-case basis:
    - 4 audit committee memberships for directors
    - 5 audit committee memberships for directors with finance expertise

Proxy Access (TSX and TSXV)

- GL supports shareholders' ability to nominate director candidates to the board using proxy access. In reviewing proxy access proposals, GL will consider factors such as minimum ownership and holding requirements, company size and performance, and board responsiveness.

Exclusive forum provisions

- GL will recommend against any bylaw adopting an exclusive form provision limiting a shareholder's choice of legal venue, unless the company can articulate a direct benefit to shareholders.

To learn more, please contact:

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