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Updates to the ISS and Glass Lewis 2013 Proxy Voting Guidelines affecting TSX and TSX-V Companies

Both Institutional Shareholder Services Inc. ("**ISS**") and Glass Lewis & Co. ("**GL**") released updates in November 2012 to their proxy voting recommendation guidelines for the 2013 shareholder meeting season. Below is a summary of the changes relevant to TSX and TSX-V listed companies.

Director Elections

Director Elections by Slate

To align with the TSX rule amendment coming into effect December 31, 2012, prohibiting the election of directors as a slate, and the similar prohibition under the TSX-V policies, ISS will recommend withholding votes from all directors nominated by slate ballot, other than on contested director elections. While the updated GL guidelines similarly noted the TSX and TSX-V rules prohibiting director elections by slate, GL indicates that it may on a case by case basis support slate director elections for companies listed on exchanges other than the TSX.

Director Election of Controlling Shareholder Nominee in Majority Owned Companies

ISS has introduced its first policy consideration for director elections in single-class common share capital structure companies controlled by a shareholder or a group of shareholders (generally holding 50 percent or more of the outstanding common shares). On a case by case basis ISS may support director nominees who are or who represent a controlling shareholder of a majority owned company if the single class company meets all of the following independence and governance criteria:

- Individually elected directors.
- The number of related directors should not exceed the proportion of the common shares controlled by the controlling shareholder, to a maximum of two-thirds, however if the CEO is related to the controlling shareholder, then at least two-thirds of the directors should be independent of management.
- If the CEO and chair roles are combined or the CEO is or is related to the controlling shareholder, then there should be an independent lead director and the board should have an effective and transparent process to deal with any conflicts of interest between the company, minority shareholders, and the controlling shareholder.
- A majority of the audit and nominating committees should be either independent directors or related directors who are independent of management. All members of the compensation committee should be independent of management, and if the CEO is related to the controlling shareholder, no more than one member of the compensation committee should be a related director.
- Prompt disclosure of detailed vote results following each shareholder meeting.
- Adoption of a majority vote standard with a director resignation policy for uncontested elections OR a public commitment to adopt a majority voting standard with a director resignation policy for uncontested elections if the controlling shareholder ceases to control 50 percent or more of the common shares.

Majority Voting Policies

The TSX rule amendments have also introduced a "comply or explain" requirement for a majority voting policy such that any issuer not adopting this policy for directors in uncontested meetings must disclose this in their management information circulars, if not adopted explain why this policy has not been adopted and explain their practices for electing directors. Furthermore, the company – if it has not adopted this policy – must notify the TSX if any director receives a majority of withhold votes. On the basis of this new "comply or explain" requirement, GL will recommend that shareholders withhold votes from all members of the company's governance committee for TSX composite companies that do not adopt a majority voting policy. While ISS has also taken note of the new TSX "comply or explain" requirement for majority voting, it has not provided a voting recommendation guideline in respect thereof.

Executive Compensation

Advisory Vote on Executive Compensation ("Say-On-Pay")

Advisory votes on executive compensation were voluntarily introduced by some companies in Canada starting in 2010 and the number of these companies has continued to increase. In 2013 ISS will be using a new quantitative screening methodology for TSX listed companies to measure executive pay-for-performance alignment based on the following two relative factors and a third absolute factor:

- The Relative Degree of Alignment: the difference between the company's Total Shareholder Return ("**TSR**") rank and the CEO's total pay rank within a peer group measured over a one-year and three-year period. ISS will construct a peer group of a minimum of 11 Canadian peer companies.
- Multiple of Median: the total compensation in the last reported fiscal year relative to the median compensation of the peer group.
- The CEO pay-to-TSR Alignment over the prior five fiscal years, i.e. the difference between

absolute annual pay changes and absolute annualized TSR changes during the prior five-year period (or as long a period as company disclosure permits).

This new screening methodology is intended to highlight companies that exhibit misaligned pay-for-performance for more in-depth review. The new screen replaces the pay-for-performance screen that ISS has been using. Companies that are identified by the screen for potential pay for performance misalignment then undergo a qualitative assessment to determine the ISS vote recommendation. ISS has not made any changes to its qualitative assessment criteria. These qualitative assessment criteria include:

- The ratio of performance- to time-based equity grants and the overall mix of performance-based compensation relative to total compensation.
- The quality of disclosure and appropriateness of the performance measure(s) and goal(s) utilized.
- The trend in other financial metrics.
- Any extraordinary situation or other factor deemed relevant.

In regard to GL's analysis of say-on-pay, the GL focus tends to be on four main areas in considering proposals:

- The overall design and structure of the company's executive compensation program.
- The quality and content of the company's disclosure.
- The quantum paid to executives.
- The link between compensation and performance as indicated by the company's pay-for-performance practices.

As well, GL has indicated a variety of problematic practices which may cause it to recommend against a say-on-pay vote, including excessive or guaranteed bonuses, out of market pay not in line with performance, and insufficiently challenging performance targets. For 2013 GL has articulated four additional concerns which may cause GL to recommend against a say-on-pay vote:

- Inadequate discussion of the company's approach to risk management, including the absence of features such as clawback mechanisms, anti-hedging policies, or executive share ownership guidelines.
- The granting of extra or 'bonus' years of unworked service for the purpose of calculating benefits under employee retirement plans.
- Inappropriate peer group and/or benchmarking issues.
- No disclosed target or maximum limits on variable compensation. When present, such limits could be set in reference to base salary.

Equity Based Incentive Plans

ISS has not revised its existing voting guidelines as regards equity based incentive plans. In GL's case, it has articulated the following as additional concerns for 2013 that could cause GL to issue an "against" recommendation:

- A plan limit set at a rolling maximum of 10 percent of a company's share capital, a limit typically established for stock option plans.
- The absence of any performance conditions or vesting provisions.
- Failure to disclose a clear description of performance hurdles and vesting schedules.
- Participation of non-executive directors on the same basis as company executives.
- Administration of the plan by non-independent members of the board.
- The inclusion of a single-trigger change of control provision.

Shareholder Rights

Advance Notice Requirement Policies

Companies may adopt advance notice requirement policies to provide a structured and transparent director nomination process under which potential proxy contests are brought to light ahead of the meeting. ISS will support, on a case-by-case basis, advance notice requirement policy proposals that provide a reasonable framework for shareholders to nominate directors whereby shareholders submit director nominations as close to the meeting date as possible but with sufficient notice for company, regulatory, and shareholder review. ISS considers a reasonable framework to be a notice deadline for shareholders' director nominations of not more than 65 and not less than 30 days prior to the meeting date. GL generally will support a proposal to adopt an advance notice requirement policy requiring shareholders to notify the company of director nominations within the same period indicated in the ISS guidance update.

Bylaw Amendment for Alternate Directors

In regards to voting recommendations on proposed amendments to bylaws, ISS has added a new area of concern relating to the ability of a sitting director to appoint an alternate. ISS will recommend against a bylaw amendment that would add an alternative director provision which permits a director to appoint another person to serve as an alternate director and to attend board or committee meetings in place of the duly elected director.

Board Responsiveness to a Significant Shareholder Vote

The engagement of the board and its responsiveness to shareholder concerns is receiving increased scrutiny by GL in 2013. In particular, GL will expect to see engagement with and responsiveness to shareholder concerns where 25 percent or more of shareholders vote against a recommendation of management, for example, in regards to director elections, amendments to articles or bylaws or shareholder advisory votes. Reaching this 25 percent threshold does not by itself guarantee a negative vote recommendation from GL on a future proposal but it will support an argument against management's recommendation where the board does not appropriately respond.

Social/Environmental Issues:

Social and environmental issues raise a host of concerns and considerations. In 2013 ISS will focus on the question of how the proposal at issue may enhance or protect shareholder value in either the short term or long term. Votes will generally be case-by-case and take into account industry and regulatory standards, any possible burden, and competitiveadvantage/disadvantage.

Links:

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