November 20, 2015

Canadian Market Update: 2016 Benchmark Policy Update

On November 20, 2015, Institutional Shareholder Services Inc. ("ISS") released their 2016 Benchmark Policy Updates following the Benchmark Policy Consultation period announced previously. These voting policies will be **applied for shareholder meetings taking place on or after Feb 1, 2016**. The updates are currently bundled in ISS' 2016 Americas Policy Updates for the Canadian, U.S., and Brazilian market and the actual restated policy documents for each of these regions will likely be made available sometime in December. In our experience, there may be changes to other areas when ISS publishes its full policies.

For the Canadian Market, ISS has made changes to the following categories: (i) "overboarding" guidelines, (ii) evaluation of equity plan proposals, and (iii) evaluation of compensation at externally managed issuers.

1. Overboarding Guidelines

As announced previously, beginning **February 1, 2017**, directors will be considered "overboarded" if he/she is: (i) a CEO of a public company who sits on more than 1 outside public company boards in addition to the company of which he/she is the CEO, or (ii) a director (not a CEO) who sits on more than four public company boards in total. The updated policy will still be "double-triggered", meaning only if **overboarded directors attended less than 75 percent of his/her board and committee meetings without valid reasons during the past year, will they receive WITHHOLD recommendations and withhold recommendations will not apply to the CEO of the subject company.**

Previously, ISS considers: (i) a CEO of a public company who sits on more than two outside public company boards in addition to the company of which he/she is the CEO, or (ii) a director (not a CEO) who sits on more than six public company boards in total as "overboarded".

Kingsdale Commentary*: ISS did not make any changes to the proposed policy announced previously. We do note that while the threshold for non-CEO directors is set at four public company boards, for the U.S., ISS will allow non-CEO directors to sit on up to five public company boards. We note that issuers have a one-year grace period before the new thresholds are in effect. Kingsdale anticipates that while certain clients may be affected by the tightened thresholds, the ISS Canadian policy is "double-triggered" and only low attendance levels will trigger this policy. But irrespective of attendance levels, "cautionary language" will be included in the ISS Reports for overboarded directors.*

2. Evaluation of Equity Plan Proposals through a Scorecard Methodology

As announced previously, ISS has finalized the "Equity Plan Scorecard" approach to evaluating equity plans to be applied beginning in the 2016 proxy season. A company's total Equity Plan Scorecard score, in combination with the overriding factors already established in Canadian policy, will determine whether support is warranted. **Clients wishing to amend or adopt their treasury-based equity plans will be affected by this new policy.**

Currently, ISS evaluates equity plan proposals through a series of bright-line tests relating to four main categories: (i) plan cost, (ii) discretionary non-employee director participation, (iii) problematic plan amendment provisions, and (iv) the ability to reprice equity awards without shareholder approval.

Unchanged from the proposed policy, the Equity Plan Scorecard will consider three pillars:

- **Plan Cost**: Assesses Shareholder Value Transfer ("SVT") against an allowable SVT cap based on industry/market cap of peers.
    - ***Kingsdale Commentary****: Under the new policy, the SVT measurement will be two-fold, (i) evaluating the total equity awards requested including awards already outstanding ("overhang") as well (ii) new requests for the equity plan only. We also anticipate that the historic "rounding" applied to the SVT of issuers to be eliminated similar to the U.S. market, tightening the level of precision in measuring SVT against the allowable cap.*
- **Plan Features**: Assesses relative dilution, existence of problematic change-in-control provisions, existence of financial assistance to plan participants for the exercise/settlement of awards, and public availability of full plan text.
    - ***Kingsdale Commentary****: This evaluation will allow for issuers to obtain redeeming scores should enough positive qualitative features be implemented to balance out "costly" plans. Conversely, negative qualitative features would jeopardize plans that could pass the SVT test and otherwise be supported by ISS before. ISS clarified in its final policies that problematic change-in-control provisions refer to the single-triggered acceleration of equity awards and assuming target (or above) performance for performance-based equity upon change-in-control. We anticipate that more details about the actual evaluation of each category will follow when ISS releases its Equity Plan Scorecard FAQ in December and we will update clients when this information become available.*
- **Grant Practices**: Assesses reasonableness of three-year average burn rate, vesting provisions for the CEO, performance-based equity ratio for the CEO, clawback provisions applicable to equity awards, and enhanced holding requirements post-exercise or settlement (for S&P/TSX Composite Index Companies only).
    - ***Kingsdale Commentary***: *The grant practices pillar appears to remain unchanged from the proposed policy. We anticipate that more details about the actual evaluation of each category will follow and we will update clients when this information become available.*

ISS also clarified that for the S&P/TSX Composite Index, the Plan Cost pillar will constitute 40% of the scores, Plan Features 20%, and Grant Practices 40%. Weightings for the non-composite TSX companies will be revealed later.

"Special Cases" models will be applied for recent IPO/bankruptcy emergence companies where burn-rate will not be assessed and more importantly, where historic grant data is not available, ISS will not evaluate factors requiring such data.

In addition to the above, ISS will continue to recommend **AGAINST** equity plan proposals that (i) allow for discretionary non-employee director participation, (ii) contain plan amendment provisions that do not adequately restrict the administrator's ability to amend the plan without shareholder approval, and (iii) explicitly allow for the repricing without shareholder approval.

Kingsdale Commentary: *For clients preparing or considering equity plan proposals for the upcoming proxy season, Kingsdale will be prepared to scrutinize proposed plans under this new regime to assess ISS' anticipated voting impact. Kingsdale will continue to monitor the developments of the Equity Plan Scorecard for the Canadian market and we expect that the scorecard approach will provide more balanced voting recommendations.*

3. Compensation Externally-Managed Issuers

Unchanged from the proposed policy announced previously, ISS finalized their evaluation for compensation practices at “externally-managed issuers” (“EMIs”) which typically pay fees to outside firms in exchange for management services with the EMI's executives typically directly employed and compensated by the external management firm.

ISS will apply a case-by-case policy framework for evaluating EMI compensation practices via recommendations on a “Say on Pay” resolution or by withholding votes from individual directors **where the EMI has provided minimal or no disclosure about its management services agreements and how senior management is compensated.** ISS discloses that it is aware of three externally-managed, TSX-listed issuers where extremely limited compensation disclosure has been provided. Factors that may be taken into consideration include:

- The size and scope of the management services agreement
- Executive compensation in comparison to issuer peers and/or similarly structured issuers
- Overall performance
- Related party transactions
- Board and committee independence
- Conflicts of interest and process for managing effectively
- Disclosure and independence of the decision-making process involved in the selection of the management services provider
- Risk mitigating factors included within the management services agreement such as fee recoupment mechanisms
- Historical compensation concerns
- Executives' responsibilities, and
- Other factors that may reasonably be deemed appropriate to assess an externally-managed issuer's governance framework.

Kingsdale Commentary*: We do not expect that this proposed policy will have significant impacts on our clients due to the rareness of EMIs. Where sufficient disclosure is already provided regarding compensation practices, it appears that ISS may not apply their new framework.*

If you have any questions about this update, please feel free to contact Victor Li or Jackie Cheung directly to discuss.

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