Kingsdale Market Update

November 17, 2017

ISS 2018 Benchmark Policy Update (Canada)

On November 16, 2017, Institutional Shareholder Services Inc. ("ISS") released its 2018 Benchmark Proxy Voting Guidelines Updates **to be applied for shareholder meetings taking place on or after February 1, 2018**. The restated guidelines, certain FAQs and an updated white paper on ISS' enhanced quantitative screening methodology are expected to be published in the next few weeks.

In the Canadian market, ISS made the following key updates to its benchmark guidelines:

(1) Harmonization of the U.S. and Canadian director overboarding policy to take effect beginning February 1, 2019. ISS will proceed with the removal of the secondary attendance trigger as originally contemplated but increase the number of boards directors can serve on before they are considered overboarded;

(2) new double-triggered gender diversity policy applicable to S&P/TSX Composite constituents for the 2018 proxy season and expanded to all TSX constituents for the 2019 proxy season;

(3) incorporating the three-year Relative Financial Performance Assessment into its quantitative pay for performance methodology as the fourth test;

(4) changes to the definition of director independence and new director categorizations as Executive Director, Non-Executive Non-Independent Director and Independent Director without any impact to vote recommendations in the case of the latter;

(5) housekeeping changes to its majority-owned company exemption policy;

(6) alignment of ISS' Advance Notice guidelines with TSX guidance (Staff Notice 2017-0001).

Items (1) and (2) are the only new policies ISS sought public comments three weeks ago on October 26, 2017. Items (3) and (4) also apply to U.S. companies.

(1) Director Overboarding (TSX)

The new overboarding policy will be in effect beginning February 1, 2019. While ISS is **still removing the secondary attendance trigger**, non-CEO directors can sit on five boards in total **(as opposed to four previously)** and CEOs of public companies can serve on two outside boards besides their own **(up from one)** before being considered overboarded. The increase in these thresholds conforms the Canadian overboarding policy to the U.S. overboarding policy. Further, although a CEO's subsidiary boards will be counted as separate boards, ISS will not recommend a withhold vote for the CEO of a parent company board or any of the controlled (>50 percent ownership) subsidiaries of that parent, but may do so at subsidiaries that are less than 50 percent controlled and boards outside the parent/subsidiary relationship.

Kingsdale Insight: This new approach conforms the Canadian policy with the U.S. version. Similar to before, we believe now it will be up to the issuer to make their case directly with shareholders given the binary nature of the policy. Comparatively speaking, Glass Lewis' overboarding policy, which has a secondary soft trigger, is still more stringent in terms of thresholds as it covers public company executives (and not just CEOs) who can only sit on one board in addition to their own in addition to two for ISS.

(2) New Gender Diversity Policy (S&P/TSX Composite in 2018)

ISS is moving forward with its newly introduced double-triggered diversity policy that would generally result in a withhold recommendation for the Chair of the Nominating Committee where a company trips both of the following triggers

(i) the company has not disclosed a formal and robust written gender diversity policy, and

(ii) there are no female directors on the board.

In instances where the Chair of the Nominating Committee cannot be identified, ISS will apply the policy to the Chair of a committee with director nominating responsibilities and, as a last resort, the Chair of the board. A company that has tripped only one of these triggers will not face adverse recommendations. As contemplated during the draft policy comment period, there will be a one-year transition period for non-S&P/TSX Composite constituents. The policy will not apply to new publicly listed issuers and TSX-V graduates within the current or prior fiscal year and companies with four or fewer directors.

Kingsdale Insight: ISS has historically considered board diversity (i.e. race and gender) as part of its evaluation during director elections, albeit only for their specialized Socially Responsible Investment and Faith-Based Proxy Voting Guidelines. Transitioning to a formal and more objective gender diversity policy within its benchmark voting guidelines reflects ISS' response to widespread stakeholder concerns regarding the lack of female representation on public company boards. Whereas ISS has updated policies in response to regulatory changes (i.e. advance notice), its gender diversity policy acts as a catalyst for increased female representation on boards and further reform. We believe that issuers with no female directors should be mindful of ISS' requirement for a robust written policy which includes a clear commitment to increase board gender diversity (goals and/or targets). In addition, issuers with only one female director should be mindful of circumstances whereby that female director resigns in advance of the AGM and be prepared to find a replacement or adopt a robust diversity policy to satisfy this requirement. Going forward, we expect ISS and institutional investors to increase their gender diversity expectations (i.e. require more than one female director or change the policy to be single-triggered).

(3) Pay for Performance Quantitative Methodology (TSX)

ISS will add a fourth test to its quantitative pay for performance screening for 2018 by examining the alignment of pay and financial performance. The new test, Relative Financial Performance Assessment (RFPA), introduced first in 2017 for information purposes only, compares the company's rankings to a peer group selected by ISS with respect to (i) CEO pay and (ii) financial performance in three or four metrics (which will vary depending on industry), in each case as measured over three years. Details of this new test will be provided by ISS in an updated white paper.

Kingsdale Insight: While this new policy didn't go through the public consultation process, we are not surprised by its introduction. The RFPA test will enhance ISS' quantitative screening by providing performance perspectives in addition to total shareholder return (TSR), which was solely relied on by ISS before. The fundamental principle of this test is no different from the current Relative Degree of Alignment (RDA) test but uses a combination of financial metrics rather than a single TSR metric. The reduction of the number financial performance metrics from six or seven to three or four is also positive. More metrics, while complicated, are not necessarily better. We further expect that ISS will not use TSR as one of the financial performance metrics to avoid the overlap between the RFPA test and the RDA test. In a few weeks, we will know the thresholds for concern levels under the RFPA but believe two "medium" level of concerns or one "high" level of concern will continue to translate into an overall "high" level of concern under the quantitative test. With one more test in the quantitative screening, issuers should be aware that chances of having concerns may increase.

(4) Definition of Director Independence (TSX and TSX-V)

ISS has made minor changes to its independence definition for director nominees and provided more transparency into what it considers professional or transactional services. The changes are meant to standardize the terminology ISS uses across other markets and does not result in any vote recommendation impacts. The current three categories of Inside Director, Affiliated Director and Independent Outside Director will be changed to Executive Director, Non-Independent Non-Executive Director and Independent Director. While most Inside Directors will be categorized as Executive Directors, the directors considered Insiders due to their controlling interest in the company will be moved to the Non-Independent Non-Executive Director category. ISS has also clarified that professional services are advisory in nature involving access to insider information or strategic decision-making and typically having a commission or fee-based payment structure. ISS has clarified particular instances that would be categorized as professional services versus transactional.

(5) Housekeeping Changes to Majority Owned Companies (TSX)

ISS has removed two criteria under its majority-owned exemption policy (TSX issuers only).

One removed criterion is the individually elected directors as TSX-listed issuers are required to provide shareholders with the ability to vote on each individual director on the ballot.

The other criterion removed is the adoption of a majority voting director resignation policy. Although controlled entities listed on the TSX may opt to voluntarily adopt a majority voting director resignation policy or otherwise disclose the rationale for not doing so, the inclusion of such a provision for a controlled entity is of limited benefit to minority shareholders. If a situation develops whereby the company is no longer controlled, the company will be required to adopt a majority voting policy consistent with other non-controlled companies listed on the TSX exchange. As such, penalizing controlled companies which have otherwise established governance practices to ensure accountability to minority shareholders and appropriate oversight of management functions may be contrary to the original premise and rationale for this policy exemption.

Kingsdale Insight: With the provisions that are required under exchange rules or are deemed extraneous in the policy's application removed, the policy now becomes cleaner and more reasonable. However, it may also indicate that ISS has no plan to further loose other criteria for controlled TSX issuers under its majority-owned exemption policy in the near future.

(6) Advance Notice Provisions (TSX and TSX-V)

For both TSX and TSXV issuers, a requirement that any nominating shareholder provide representation that the nominating shareholder be present at the meeting in person or by proxy at which his or her nominee is standing for election for the nomination to be accepted, notwithstanding the number of votes obtained by such nominee, will be deemed problematic and trigger negative voting recommendation by ISS.

In addition, with respect to the problematic provision that gives the board discretion to request excessive additional disclosure of the nominating shareholder(s) or the shareholder nominee(s), ISS has removed the part of "in any event where there is no indication from the company that such additional disclosure, if requested and received, will be made publicly available to shareholders".

Kingsdale Insight: The addition of the first problematic provision is expected as ISS started to recommend against advance notice provisions that requires a nominating shareholder's presence at the meeting regardless of the number of votes obtained by his or her nominee in the 2017 proxy season in light of the TSX guidance, which was published on March 9, 2017 (Staff Notice 2017-001), that clarified that a provision contained within an advance notice provision "requiring the nominating security holder to be present at the meeting at which his or her nominee is standing for election for the nomination to be accepted, notwithstanding the number of votes obtained by such nominee" would not be "consistent with the policy objectives of the Director Election Requirement."

The update on the second problematic provision is further strengthened with the purpose of eliminating any possibility of including broad discretion to require additional information that goes beyond what is required under law or regulations.

If you have any questions about this update, please feel free to contact Kingsdale's experts listed below to discuss directly.

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