

ISS 2020 Benchmark Policy Updates

Canada Policy Updates

On November 12, 2019, Institutional Shareholder Services, Inc. ("ISS") released its 2020 Proxy Voting Guidelines updates to be applied for shareholder meetings taking place on or after February 1, 2020.

This year's policy update process included an open comment period, running from October 7 to October 18, 2019, whereby governance stakeholders were asked to provide feedback on seventeen proposed new voting policies or potential policy changes slated for 2020 – none of which applied to Canadian issuers.

The full restated guidelines, which may contain further minor changes in addition to those described herein, are expected to be published later this month and certain frequently asked questions are expected to be published by early- to mid-December 2019.

For the Canadian market, ISS has introduced what we deem as minor policy updates and clarifications on six existing categories: (i) Ratification of Auditors and Excessive Non-Audit Fees (TSX and Venture); (ii) Policy Considerations for Majority Owned Companies (TSX and Venture); (iii) Director Attendance (TSX); (iv) Former CEO/CFO on Audit/Compensation Committee (TSX); (v) Overboarded Directors (TSX); and (vi) Equity-Based Compensation Plans (Venture). No new policies have been added in addition to these guideline modifications.

Notably, the previously considered changes to ISS's quantitative Pay-for-Performance model are now official: ISS will incorporate the use of Economic Value Added (EVA) metrics in the model's secondary Financial Performance Assessment (FPA) screen. The updated Pay-for-Performance Mechanics whitepaper, including details of the introduction of EVA into the FPA secondary screen of the pay-for-performance quantitative model for U.S. markets, is expected to be published in early- to mid-December 2019.

Director Voting in Uncontested Elections

- **Ratification of Auditors and Excessive Non-Audit Fees (TSX and Venture)**

When ISS determines exceptions to the standard "non-audit (other) fee" category in assessing whether non-audit fees are excessive, ISS will not limit the significant one-time capital restructure events to IPOs, emergence from bankruptcy, and spinoffs. ISS will now acknowledge fees related to some M&A transactions, including dispositions, while re-domiciliation may qualify as a one-time fee eligible for a carve out. In order to warrant a carve out, however, M&A transactions need to be significant non-routine events that materially impact a company's capital structure/organization.

Note that ISS is not changing its disclosure requirement with regard to the carve out and one-time capital structure event fees are eligible to be carved out from "non-audit fees" *only* if there is adequate disclosure about any transaction and a clear breakdown of the fees.

Kingsdale Insight: While ISS is loosening its criteria in carving out one-time fees from “non-audit (other) fees” by taking M&A transactions and re-domiciliation into consideration, the proxy advisor will continue to scrutinize company disclosure when determining carve out eligibility. Companies that acquire and dispose of assets on a regular basis, or do not adequately disclose the fees associated with M&A transactions, may not be eligible for a carve out. ISS will apply this policy change to its assessment of (i) voting on Audit Committee members in uncontested elections and (ii) ratification of an auditor resolution, which is a routine matter and not related to the election of director nominees in uncontested situations.

- **Policy Considerations for Majority Owned Companies (TSX and Venture)**

ISS’s case-by-case support of director nominees who are, or who represent, a controlling shareholder of a majority owned company upon meeting all specified independence and governance criteria will be limited to only non-management director nominees. This policy will not be considered at dual-class companies having common shares with unequal voting or unequal board representation rights. ISS will not support director nominees who are executives, regardless of whether or not they also are or represent a controlling shareholder and are members of the Audit Committee.

Kingsdale Insight: ISS has clarified that, at majority owned companies, its case-by-case exemption of directors who are controlling shareholders, or representing controlling shareholders – under ISS’s board and committee independence policies – is not intended to support management directors.

- **Director Attendance (TSX)**

When evaluating directors’ attendance, exceptions will be made by ISS for director nominees who served for (i) only part of the fiscal year, or (ii) newly publicly listed companies, or (iii) companies that have recently graduated to the TSX on a case-by-case basis.

ISS also clarifies that its 75% attendance threshold is calculated upon the aggregate of an individual director’s board and key committee (audit, compensation and nominating) meetings.

Kingsdale Insight: As a reminder, ISS generally recommends voting withhold for directors if (i) the company has not adopted a majority voting director resignation policy AND the director attended less than 75% of board and committee meetings without a valid reason for absence or (ii) the company has adopted a majority voting director resignation policy AND the director attended less than 75% of board and committee meetings without a valid reason for absence AND a pattern of low attendance exists based on prior years’ meeting attendance.

ISS recognizes that venture issuers are not required to disclose the attendance record of each director pursuant to National Instrument 58-101F1 and therefore may not apply its ISS attendance policy to companies that has completed its initial public offering or has graduated to TSX in the current fiscal year. ISS also assesses director nominees who have not served during the full fiscal year on a case-by-case basis.

- **Former CEO/CFO on Audit/Compensation Committee (TSX)**

Pursuant to the new policy, ISS will recommend shareholders withhold votes from any Audit or Compensation Committee member who has served as the CEO of the company or its affiliates within the past five years, or as CEO of a company acquired within the past five years.

ISS will continue to evaluate the independence of any former CEO on the Audit or Compensation Committee following a five-year period after leaving this executive position on a case-by-case basis.

ISS will also generally vote withhold for any Audit or Compensation Committee member who has served as the CFO of the company or its affiliates within the past three years, or of a company acquired within the past three years.

Kingsdale Insight: ISS defined “affiliates” as a subsidiary, sibling company, or parent company, using 50% control ownership by the parent company as the standard for applying its affiliate designation. Factors ISS considers in determining the independence of former CEO after the five year cooling-off period may include the following instances: management/board turnover; current or recent involvement in the company; whether the former CEO is or has been Executive Chairman of the board or a company founder; length of service with the company; any related party transactions; consulting arrangements; and any other factors that may reasonably be deemed to affect the independence of the former CEO.

- **Overboarded Directors (TSX)**

Transitioning directors will now be factored into ISS’s evaluation of director overboarding. ISS will generally not count a board for policy application purposes when it is publicly-disclosed that the director will be stepping off that board at its next annual meeting. This disclosure must be included within the company’s proxy circular to be taken into consideration. Conversely, ISS will include any new boards that the director is joining even if the shareholder meeting with his or her election has not yet taken place.

Kingsdale Insight: Previously, ISS would consider a director overboarded at the subject company irrespective of whether that director intended to resign from any directorships subsequent to the subject company’s annual meeting. ISS will now consider exemptions of an outside board seat, if the subject company disclosed—in its circular—a director’s intent to resign from that outside board.

Executive Compensation

- **Equity-Based Compensation Plans (Venture)**

ISS will generally vote against an equity compensation plan proposal if the plan is a rolling equity plan that enables auto-replenishment of share reserves without requiring periodic shareholder approval at least every three years (i.e. evergreen plan).

For meetings on or after February 1, 2021, ISS will generally vote withhold for the continuing Compensation Committee members (or in cases where Compensation Committee members have not been identified and the entire board fulfills the role of Compensation Committee, vote withhold for the board chair), if the company maintains an evergreen plan AND has not sought shareholder approval in the past two years AND does not seek shareholder approval of the plan at the meeting.

Kingsdale Insight: ISS is implementing these new policies against the backdrop of a growing number of CSE companies (primarily Cannabis companies) who do not require regular shareholder reapproval of rolling limit plans. For companies that do not ask for shareholder approval of their evergreen plans at least every three years, ISS will first recommend a vote against the equity plan and then, after one year, withhold on Compensation Committee members.

SEC Regulation on Proxy Advisors

On November 5, an SEC panel voted along party lines, in a 3-2 vote, to issue proposed rules about proxy advisors. The proposed rules will be open for public comment for 60 days; comments can be submitted via SEC’s website, [here](#). The proposed rules impose new conditions for proxy advisors to meet in order to qualify for exemptions from the existing proxy solicitation rules. One of the conditions requires the proxy advisors to share draft proxy papers with subject companies twice before such reports can be shared with the proxy advisors’ clients. Other requirements include additional disclosures of methodology used to formulate advice and deviations from previous guidelines, third-party sources used, and conflicts of interests.

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The codification of the proposed rules will likely be a lengthy process and not take effect during the 2020 proxy season. In our view, the proposed rules will make it more difficult for proxy advisors to qualify for exemptions from existing proxy solicitation rules, and also puts proxy advisory firms in a more difficult position to make independent and unbiased recommendations and make them available to their clients in a timely fashion. Put another way, the new rules will lead to a shift of power from shareholders to the hands of management. More importantly, if the rules do go into effect in the future, none of the potential outcomes as outlined below will necessarily benefit public issuers when it comes to engaging with shareholders:

1. Proxy advisors fully exit the “proxy voting advice businesses”.
2. Proxy advisors continue to operate under the existing model and comply with the new rules, however, pass down the additional operating cost to their subscribers. In this scenario, the proxy advisors may also move the final proxy voting recommendations closer to the shareholder meeting dates.
3. Proxy advisors continue to operate under a different model by reducing its service to pure data aggregation and not providing actual proxy voting recommendations.
4. Proxy advisors may develop different business models for the U.S. market while keeping the existing business model for non-U.S. markets (e.g. Canada and Europe), until the regulatory bodies in those jurisdictions also take corresponding actions.

In each case, institutional shareholders will have to spend extra resources and/or time to analyze proxy materials and draw voting decisions, which may potentially diminish the opportunities and effectiveness of their engagement efforts. Therefore, in our view, the key issue here is not the proxy advisors themselves but whether or not a company believes a shareholder is capable of making a fully informed decision, regardless of what ISS and Glass Lewis might say.

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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