Kingsdale Market Update

October 26, 2018

Glass Lewis 2019 Proxy Voting Guidelines

Canadian Policy Update

On October 24, 2018, Glass, Lewis & Co., LLC ("Glass Lewis") released its 2019 Proxy Voting Policy Guidelines for the Canadian market as part of its annual policy update process. These guidelines will be effective for shareholder meetings held on or after January 1, 2019 unless otherwise noted.

The proxy advisor has introduced major updates in three existing categories: (i) board gender diversity, (ii) environmental and social risk oversight, and (iii) virtual shareholder meetings. It has also added two new sections including board skills and director and officer indemnification. Minor clarifications and additions were made for the ratification of auditor, contractual payments and arrangements, grants of front-loaded awards, recoupment provisions, and other executive compensation matters.

Notably for the first time Glass Lewis is publicly seeking ongoing comments to its guidelines from all market participants as part of its increasingly transparent policy formulation process.

General Governance

Board Gender Diversity

As previously announced about a year ago, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members at meetings held on or after January 1, 2019. Glass Lewis may also recommend voting against the nominating committee chair if the board has not adopted a formal written diversity policy. The adverse recommendation may be extended to other nominating committee members depending on factors such as company size, industry, gender diversity on the management team, the company's overall governance profile, and whether there are other board composition concerns.

When making these recommendations, Glass Lewis will also carefully review a company's disclosure of diversity considerations and may refrain from recommending that shareholders vote against[1] directors of companies outside the S&P/TSX Composite Index, when boards have provided a sufficient rationale for not having any female board members, or when companies have disclosed a plan to address the lack of diversity on the board.

[1] We note that Glass Lewis has consistently used the term "vote against" while shareholders can only vote "for" or "withhold" votes from directors. That said, we expect the voting options will allow "against" votes in the near future once the amended Canada Business Corporation Act comes into effect and other provincial acts follow suit.

***Kingsdale Commentary**: It appears that the initial policy application will apply mostly to S&P/TSX Composite Index issuers in 2019. The primary screen Glass Lewis applies will be whether the board has at least one female director. Notably, while Glass Lewis was consistent with its proposed board gender diversity policy announced in November 2017, it has loosened its requirements replacing it with a broader diversity policy. This policy shift recognizes that a handful of issuers have adopted general diversity plans that also consider gender as a factor.*

Environmental and Social ("E&S") Risk Oversight

For large cap companies and in instances where Glass Lewis identifies material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of E&S issues.

In its update, Glass Lewis has clarified its position and notes that it may recommend that shareholders vote against directors, who have been charged with oversight of E&S issues in instances where companies failed to properly manage or mitigate E&S risks to the detriment or threat of shareholder value.

In addition to this policy, Glass Lewis has added that it will recommend voting against all members of the audit committee who presided over a significant failure to oversee material E&S risks in the absence of a separate committee with designated E&S risk oversight functions. On a case-by-case basis, Glass Lewis will review each situation and its impact on shareholder value and the company's response when making these recommendations.

***Kingsdale Commentary**: It appears that this policy mainly applies to S&P/TSX Composite Index companies. Glass Lewis will first examine whether the board has delegated E&S oversight to certain directors or board-level committees and clearly defined the oversight structure in their governance documents. Subsequently, under circumstances where significant failures of E&S risk oversight occur, Glass Lewis will hold corresponding directors or committees responsible.*

Virtual-Only Shareholder Meetings

Starting in 2019, companies that choose to hold their annual shareholder meeting by virtual means, and without the option of attending the meeting in person, may be subject to against recommendations. Specifically, Glass Lewis will examine a company's disclosure of its virtual meeting procedures and could recommend voting against members of the governance committee if the company does not provide disclosure assuring that shareholders will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

Glass Lewis will be looking for examples of effective disclosure including:

(i) addressing the ability of shareholders to ask questions during the meeting, including time guidelines for shareholder questions, rules around what types of questions are allowed, and rules for how questions and comments will be recognized and disclosed to meeting participants;
(ii) procedures, if any, for posting appropriate questions received during the meeting, and the company's answers, on the investor page of their website as soon as is practical after the meeting;
(iii) addressing technical and logistical issues related to accessing the virtual meeting platform; and
(iv) procedures for accessing technical support to assist in the event of any difficulties accessing the virtual meeting.

***Kingsdale Commentary**: Beginning in 2019, Glass Lewis will make voting recommendations on virtual-only shareholder meetings, with a focus on appropriate disclosures in a company's circular that ensures fairness to shareholders rights. In its update, Glass Lewis has provided several examples of disclosure that companies may consider using when holding virtual-only shareholder meetings.*

Board Skills – New

Glass Lewis has updated its guidelines with a new section regarding board skill matrices to assist in evaluating board competencies and potential skill gaps. While no voting impact has been discerned from this new policy, Glass Lewis will include board skill matrices in its analysis of director elections at S&P/TSX 60 Index companies.

Director and Officer Indemnification – New

Glass Lewis has added a section with respect to its stance on indemnification provisions for directors and officers. Specifically, Glass Lewis finds it appropriate for companies to provide indemnification and/or enroll in liability insurance to cover its directors and officers, so long as the terms of such agreements are reasonable.

Ratification of Auditor – Additional Considerations

When reviewing an auditor vote, Glass Lewis will consider an auditor's tenure, a pattern of inaccurate audits, and any ongoing litigation or significant controversies which call into question an auditor's effectiveness. In limited cases, these factors may contribute to a recommendation against auditor ratification.

Executive Compensation

Contractual Payments and Arrangements

Glass Lewis has extended its policy regarding contractual payments and arrangements and has clarified the terms that may contribute to a negative recommendation on a say-on-pay proposal.

***Kingsdale Commentary**: Certain contractual payments and arrangements, such as excessive severance and generous sign-on bonuses, are contrary to the pay-for-performance principle and can be costly to companies given shareholders' inability to predict whether the paid executives can deliver value or not. Companies should avoid such problematic pay practices when hiring new executives.*

Grants of Front-Loaded Awards

When evaluating such awards, Glass Lewis takes quantum, design, and the company's rationale for granting awards into consideration. Glass Lewis believes that there are certain risks associated with the use of this structure.

***Kingsdale Commentary**: It is expected that Glass Lewis wants any front-loaded awards to include a firm commitment not to grant additional awards for a defined period. While it may be understandable that the use of front-loaded awards is intended to lock-in executive service and incentives, companies should be wary of such an approach.*

Recoupment Provisions ("Clawbacks")

Glass Lewis will be increasingly focused on the specific terms of recoupment policies beyond whether a company maintains a "clawback" that simply satisfies the minimum legal requirements.

Kingsdale Commentary*: While no voting impact has been indicated, Glass Lewis will closely evaluate the specific terms of recoupment policies, which are suggested to be robust and expansive, allowing for the recoupment of both short and long-term incentive awards in cases of financial restatement or misconduct.*

Other Executive Compensation Clarifications

Glass Lewis has updated its language in its discussion of how peer groups contribute to recommendations, revising the description of its pay-for-performance model, and adding discussion on the consideration of discretion in incentive plans. Glass Lewis has also added an explanation of the structure and disclosure ratings in its Proxy Papers and addressed certain recent developments in its discussion of director compensation and bonus plans.

Shareholder Initiatives Policy Updates

Glass Lewis has introduced significant policy changes in a total of six categories within the Shareholder Initiatives space dealing with various types of shareholder proposals, including: (i) Diversity Reporting, (ii) Materiality Considerations, and (iii) Written Consent.

Additional commentary on (i) Conflicting and Excluded Proposals, (ii) E&S Risk Oversight, and (iii) Recoupment Provisions are addressed in the general 2019 Canadian Policy Guidelines.

Diversity Reporting

For 2019, Glass Lewis will generally recommend that shareholders vote in favour of shareholder proposals that request additional reporting regarding a company's diversity initiatives. Specifically, Glass Lewis will support proposals targeting disclosure of workforce diversity including tangible details concerning the methodology of promoting further diversity. When applying these recommendations to specific shareholder proposals, Glass Lewis will consider the following four mitigating factors: (i) the industry in which the company operates and the nature of its operations, (ii) the company's current level of disclosure regarding workplace diversity, (iii) the level of disclosure at the company's peers, and (iv) any lawsuits or accusations of discrimination within the company.

Kingsdale Commentary: *Despite increasing support for the continued evolution in the workplace diversity space, and Glass Lewis' endorsement for diversity initiatives in general, the proxy advisor has defined certain instances where the application of increased disclosure may be reconsidered. Regardless, clients are still advised to adopt general diversity policies as a minimum best practice. This is particularly important when there is a lack of diversity on the board or at the management level.*

Materiality Considerations

In conjunction with further developments in the E&S space, Glass Lewis has normalized the concept of materiality when providing recommendations for these types of shareholder proposals. It is Glass Lewis' belief that E&S risks will be differentiated on a company-by-company basis, taking into account differences in a variety of factors including operations, workforce, structure, and geography. Given these implicit differences in the application of risk, Glass Lewis will place ultimate emphasis on the financial implications for a company implementing any proposed shareholder resolution. Glass Lewis will consider the standards developed by the Sustainability Accounting Standards Board ("SASB") as a resource to assist in determinations of financial materiality.

Kingsdale Commentary: *Given the continued interest and development of E&S issues, Glass Lewis is now placing greater emphasis on the financial implication of E&S proposals. By formalizing an approach to assessing the case-by-case financial impacts of adopting such shareholder proposals, Glass Lewis' E&S framework continues to evolve.*

Written Consent

Despite general support for the right of shareholders to act by written consent, Glass Lewis has added a mediating note regarding proxy access and special meeting rights. Specifically, Glass Lewis will generally recommend against shareholder proposals to modify by-laws to facilitate the right to act by written consent in instances where a company has previously adopted a special meeting right of 15%, or below, alongside reasonable proxy access provisions. In keeping with this guideline, Glass Lewis maintains its position that special meetings are preferable to action by written consent, given the greater degree of minority shareholder protection and capability for management response at a special meeting.

Kingsdale Commentary: *It appears that Glass Lewis has a preference for special meetings over action by written consent. This indicates that, if the company already has a special meeting right of 15% or reasonable proxy access provisions in place, Glass Lewis will generally not support the shareholder proposals for the adoption of action by written consent.*

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