

2021 PROXY SEASON SNAPSHOT: PAY, PERFORMANCE AND PUBLIC OUTCRY

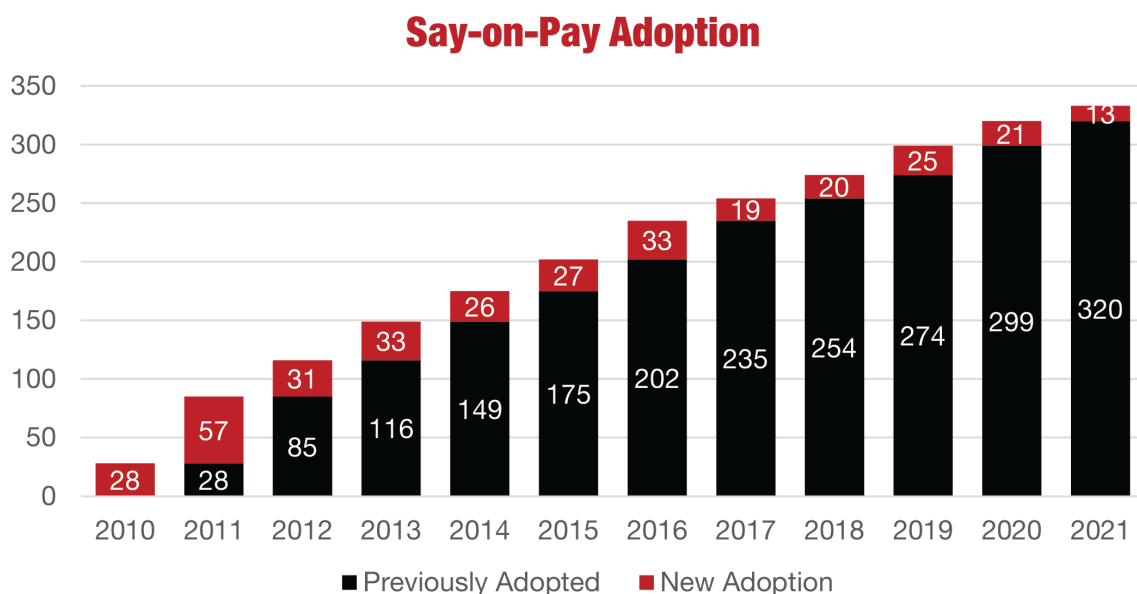
It has been over a year since the COVID-19 pandemic disrupted the operations of many companies around the world. As management teams grappled to understand its implications on their industries and scrambled to save their businesses from plummeting for reasons out of their control, corporate boards focused on retaining and engaging their executives.

When setting or adjusting executive compensation in 2020, boards shifted away from strictly quantitative, pre-pandemic programs that failed to consider the impacts of COVID-19. Instead, they adopted tactics such as revising financial metrics and incentive thresholds, focusing on strategic initiatives, and exercising discretion.

While there are still lingering economic impacts from COVID-19, during the 2021 proxy season we saw a shift in tone from proxy advisors, shareholders and the public at large, who scrutinized high executive compensation in the face of drastic financial and operational underperformance.

Say-on-Pay Adoption

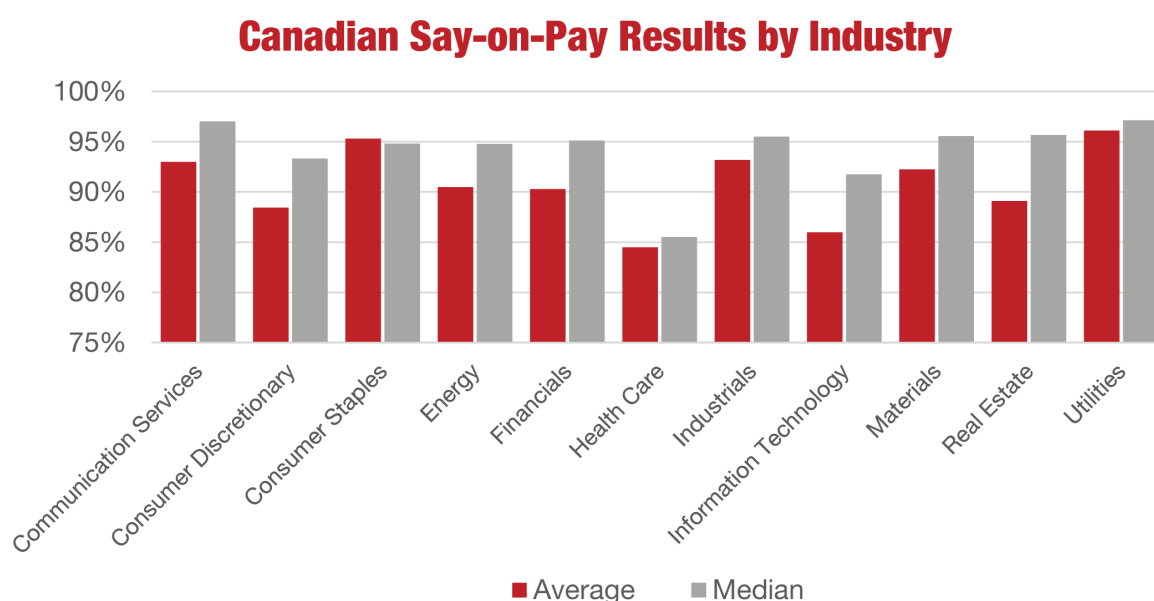
To date, we saw 13 companies voluntarily adopt a say-on-pay (SOP) vote, a significant decrease from 2020 and 2019, which had 21 and 25, respectively. This decrease isn't surprising as the overall rate of adoption had been levelling off in the last few years. The majority of large issuers, and S&P/TSX Composite issuers in particular, have already adopted SOP so we expect to see numbers continue to slow.



Shareholder Support Levels

The average support level across the 208 companies that have reported their SOP voting results to date is approximately 91%, similar to prior years.

The healthcare sector has had the lowest average SOP support level (84.48%), while the utilities sector had the highest (96.10%). Issuers in the energy and materials sectors remain the most active adopters to date, with a total of 40 energy sector companies and 55 materials sector companies having had SOP votes.



While the highest support percentage was approximately 99% (Storm Resources Ltd.), the lowest support percentage was just shy of 25% (RioCan Real Estate Investment Trust), a marked decrease from the lowest support percentage of approximately 46% and 39% in 2020 and 2019, respectively.

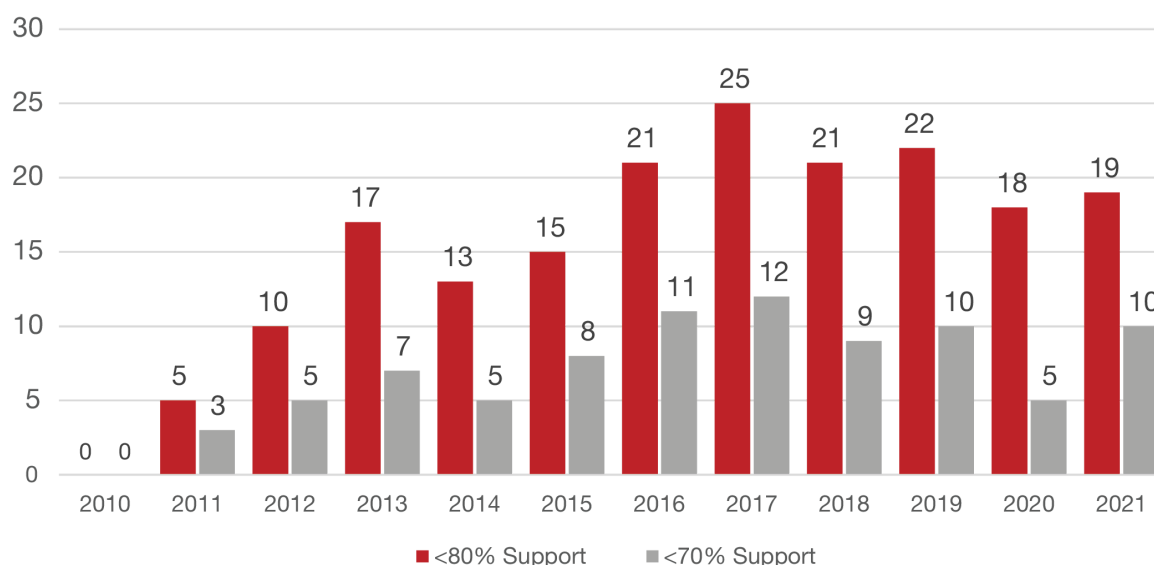
Although SOP remains voluntary in Canada, we continue to advise companies to adopt SOP votes, both as a best practice and as an added protection for compensation committee members who might otherwise receive withhold recommendations from proxy advisors and withhold votes from displeased shareholders.

Companies with Less Than 80%/70% Support

Institutional Shareholder Services (ISS) expects companies to demonstrate reasonable “responsiveness” in addressing shareholders’ concerns if their SOP proposals receive less than 70% of shareholders’ support, while Glass Lewis’ line is 80%.

To date, 19 companies have received sub-80% support levels on their SOP votes, compared to 18 in 2020. Seven of these companies received sub-80% support levels despite receiving positive SOP recommendations from both ISS and Glass Lewis, further suggesting that institutional shareholders are increasingly willing to “go their own way” when determining whether executive compensation is in line with shareholder expectations and financial performance. Notably, a record 10 companies have received an AGAINST recommendation from both ISS and Glass Lewis, compared to only one in 2020 and three and five in 2019 and 2018, respectively.

Companies with Less Than 80%/70% Support



Failed Say-on-Pay: Compensation vs. Performance

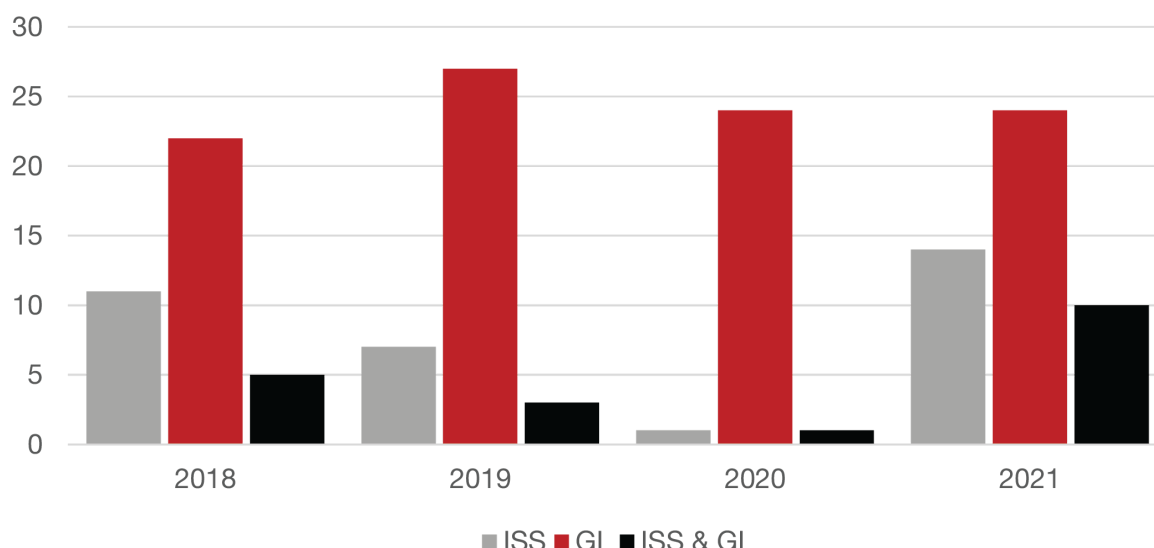
Despite the pandemic's ongoing economic impacts, ISS has made 14 AGAINST recommendations to date – significantly higher than 1 in 2020, 7 in 2019 and 11 in 2019. ISS' most common reasons for making AGAINST recommendations were:

- One-time cash payments or equity awards that are considered excessive, lack reasonable rationale, or are not aligned with company performance;
- High pay for performance concerns, usually due to high Relative Degree of Alignment concern, indicating a higher-than-peer pay and a weak Total Shareholder Return (TSR) performance over the preceding three years; and
- Misalignment of pay and performance compared to self-disclosed peers in terms of TSR performance and operational performance.

Glass Lewis also provided no leniency, maintaining its historically aggressive approach of recommending AGAINST companies. To date, Glass Lewis has made 24 AGAINST recommendations, which is tracking to be aligned with 24 and 27 AGAINST recommendations in 2020 and 2019, respectively. Glass Lewis' most common reasons for making consistent AGAINST recommendations were:

- Upward discretion on short-term incentives and long-term incentives;
- Significant one-off special awards to executives;
- Insufficient disclosure of short-term or long-term incentive plan goals; and
- Grade "F" per Glass Lewis' proprietary pay for performance model, indicating a poor alignment of pay and performance.

Proxy Advisor "Against" Recommendations



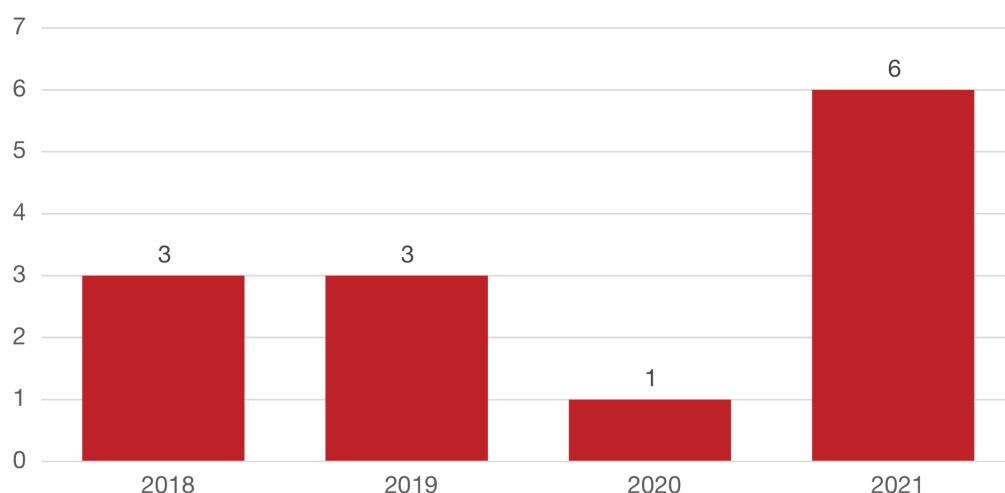
It's notable that both ISS and Glass Lewis were critical of one-time cash and/or equity awards to executives. While boards may see these actions as one-time only, they will likely have a lasting and negative 'overhang' impact on proxy advisor metrics, such as the three-year average for CEO compensation.

Other actions taken by boards to retain executives and reward them for managing and shepherding their businesses during a global healthcare crisis included:

- Shifting quantitative financial metrics to strategic initiatives or other qualitative metrics;
- Upward discretion on final payout multipliers;
- One-time bonus or equity grants;
- Lowering short-term and/or long-term incentive thresholds or targets;
- Adjustments to the operational results to meet financial thresholds or targets; and
- Retroactively adjust pro-rata performance periods to separate them into pre-pandemic and pandemic periods.

Year-to-date, six companies have failed their SOP votes – four of which are TSX composite issuers – compared to only one in 2020 (Copper Mountain Mining Corporation). However, as we noted earlier, 2020 saw a disproportionately high level of support as ISS, Glass Lewis and most institutional shareholders took a more lenient approach due to the COVID-19 pandemic. Nevertheless, the number of failed SOP votes year-to-date doubles the three failed SOP votes in each of 2019 and 2018.

Failed Say-on-Pay Resolutions



The significantly higher number of failed SOP votes to date are attributable to several factors, including proxy advisors being generally unsupportive of discretionary changes to executive compensation, viewing such actions as improperly trying to retain executives at the expense of shareholders and employees and in the face of drastic financial and operational underperformance.

Additionally, many institutional shareholders are increasingly adopting their own internal voting guidelines with more specific – and sometimes more stringent – requirements on executive compensation. Such investors have become more engaged and, in some instances, skeptical of some compensation committees’ philosophies on executive compensation during the pandemic. In certain instances where ISS and Glass Lewis supported a particular SOP vote, some institutional shareholders chose to vote against SOP by prioritizing their own internal guidelines over the recommendations of proxy advisors.

Public Outcry

Another reason for a higher number of failed votes may have been due to investors viewing such a vote as a “say-on-performance” or “say-on-impact” vote. As such, certain investors, such as retail investors, who saw their investments significantly eroded would have certainly objected to any discretionary actions taken by issuers to reward executives in a very challenging business environment. Likewise, employees and their unions also took the stance that management should not be rewarded in a time when many lost their jobs or elements of their compensation.

We specifically note Air Canada, whose reported \$10 million in “COVID-19 Pandemic Mitigation Bonuses” and other special stock awards resulted in public backlash. While the company later clarified that the majority of the bonus went to non-executives, the pressure ultimately resulted in its executives returning their bonuses and stock awards. Despite these gestures, the Government of Canada still voted against SOP.

Blackberry Ltd. is another example of public scrutiny when executive pay fails to align with performance, after an investor publicly advocated for the dismissal of lead director Prem Watsa. Glass Lewis also recommended that shareholders vote against Mr. Watsa's election, stating that the company "has been deficient in aligning pay with performance for each of the last three fiscal years." Although Mr. Watsa was ultimately re-elected as the chair of the compensation committee with an 82.56% supporting vote, Blackberry itself only received 58.77% on its SOP vote.

These examples suggest a heightened level of public awareness and scrutiny due to greater press coverage of executive compensation against financial and operational performance.

Kingsdale's Take

The extraordinary events of 2020 have shone a light on executive pay and performance, with both proxy advisors and shareholders giving a one-time only allowance to board adjustments in order to retain key executives.

Going forward, we expect all stakeholders to pay closer attention to the pay-performance relationship. As companies face ongoing uncertainty in predicting when performance levels will return to normal, we expect boards will continue to opt for compensation programs that help retain and incentivize executives, while also giving flexibility to assess year-end financial and operational results in order to make more holistic compensation decisions, such as non-financial or strategic objectives, delaying financial forecasts, or exercising discretion on short and long-term incentive plans, and one-time equity or bonus payouts.

The challenge for boards will be to use these options carefully. Boards should set performance targets as realistically as the situation allows and include measures that will have material impact on performance, only giving upside bonus potential for out-performance.

Boards will also need to provide full and transparent disclosure on their decisions for compensation as well as how and why specific performance measures were set. Without this context, boards will be seen as simply lowering the performance bar and likely face criticism from proxy advisors, shareholders and the broader public.

Energy Producers vs. ESG

This proxy season saw a dramatic win for Engine No.1 in its proxy fight against Exxon Mobil by installing three of its nominees to the Exxon board with a goal of reducing Exxon's carbon footprint. The mostly unknown small hedge fund owned just 0.02% of Exxon but managed to gain the support of institutional investors BlackRock, Vanguard and State Street, who collectively owned nearly 20% of Exxon's shares.

Exxon wasn't the only energy producer to suffer defeat on its climate agenda recently. Chevron's shareholders voted approximately 61% in favour of an activist proposal seeking to cut Chevron's carbon emissions. Similarly, a Dutch court recently ordered Royal Dutch Shell to cut its carbon emissions by 45% in the next 10 years.

Energy producers should view these developments as acceptance that shareholders are increasingly insisting on meaningful action on climate change and are resolved to ensuring that boards have the requisite experience to deliver on shareholder expectations on climate matters.

In recent years, investors, particularly institutional investors, have shown a growing focus on ESG issues, including minimizing a company's environmental footprint and ensuring positive steps to combat climate change. If companies are unwilling or unable to get in front of ESG-related disclosures and risk mitigation expectations on their business, we expect their shareholders or other stakeholders will compel them to. We also expect that progress towards meeting ESG, and climate-related targets will increasingly be reflected in executive compensation plans as another element of payment for performance.

Diversity: The Path to BIPOC Equality

It has been over a year since the Canadian Business Corporation Act's (CBCA) diversity disclosure requirements – which prompts CBCA distributing companies to “comply or explain” the adoption of, or lack thereof, a diversity target – came into effect. However, to date, diversity, both in terms of disclosure and in filled positions, beyond gender remains uncommon.

Among the S&P/TSX 60 issuers, only 1.86% of boards members are identified as visible minorities, 0.53% are identified as Indigenous persons (First Nations, Inuit, and Métis), and only 0.27% are identified as a person with a disability.*

However, we expect the topic diversity – gender, racial and more – will be an increasing focal point in shareholder engagement moving forward. In April, the TMX Group agreed to support a proposal from the Shareholder Association for Reach and Education (SHARE), which represented the Atkinson Foundation, and report to shareholders on its work on Indigenous inclusion.

We expect this agreement to create a ripple effect in capital markets. It's rare for publicly traded companies to recommend that investors approve shareholder proposals, but the agreement is also believed to be a first-of-its-kind endorsement by a board of directors of a Canadian company to support an investor resolution about Indigenous inclusion. We also expect that the TMX Group decision has the potential to directly and indirectly influence other listed issuers to consider and support similar proposals.

While the focus in previous years was on financial activism as the primary driver for governance changes, we believe a shift is occurring: social activism focused upon diversity, particularly as it relates to Blacks, Indigenous and People of Colour. We believe the pressure and focus we have seen on SOP votes may soon be replaced by an SOD movement – say-on-diversity.