

2018

PROXY PAPER™

# GUIDELINES

AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE

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## CANADA



GLASS LEWIS

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# Guidelines Introduction

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## SUMMARY OF CHANGES FOR THE 2018 CANADA POLICY GUIDELINES

### BOARD GENDER DIVERSITY

We have added a discussion of how Glass Lewis considers gender diversity on boards of directors. As with previous years, Glass Lewis will continue to closely review the composition of the board and may note as a concern instances where we believe the board lacks representation of diverse director candidates, including those boards which have no female directors.

In 2018, we will not make voting recommendations solely on the basis of the diversity of the board; rather, it will be one of many considerations we make when evaluating companies' oversight structures. Beginning in 2019, however, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members, or that has not adopted a formal written gender diversity policy. Depending on other factors, including the size of the company, the industry in which the company operates and the governance profile of the company, we may extend this recommendation to vote against other nominating committee members. When making these voting recommendations, we will carefully review a company's disclosure of its diversity considerations and may refrain from recommending shareholders vote against directors of companies outside the S&P/TSX Composite index, or when boards have provided a sufficient rationale for not having any female board members, or have disclosed a plan to address the lack of diversity on the board.

### DUAL-CLASS SHARE STRUCTURES

We have added a discussion of how Glass Lewis considers dual-class share structures when analyzing a company's governance. Glass Lewis believes dual-class voting structures are typically not in the best interests of common shareholders and that allowing one vote per share generally operates as a safeguard for common shareholders by ensuring that those who hold a significant minority of shares are able to weigh in on issues set forth by the board.

With regards to our evaluation of corporate governance following an IPO or spin-off within the past year, we have not changed our general approach; however, we will now include the presence of dual-class share structures as an additional factor in determining whether shareholder rights are being severely restricted indefinitely.

### BOARD RESPONSIVENESS

In light of evolving investor sentiment, we have clarified that we consider that the board generally has an imperative to respond to shareholder dissent from a proposal at an annual meeting of more than 20% of votes cast — particularly in the case of a compensation or director election proposal.

With regards to companies where voting control is held through a dual-class share structure with disproportionate voting and economic rights, we will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders when determining whether board responsiveness is warranted. Where vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal, we believe the board should demonstrate an appropriate level of responsiveness.

## VIRTUAL SHAREHOLDER MEETINGS

Glass Lewis is aware that a relatively small but growing contingent of companies have elected to hold shareholder meetings by virtual means only. We believe that virtual meeting technology can be a useful complement to a traditional, in-person shareholder meeting by expanding participation of shareholders who are unable to attend a shareholder meeting in person (i.e., a “hybrid meeting”). However, we also believe that virtual-only meetings have the potential to curb the ability of a company’s shareholders to meaningfully communicate with the company’s management.

In 2018, we will not make voting recommendations solely on the basis that a company is holding a virtual-only meeting. When analyzing the governance profile of companies that choose to hold virtual-only meetings, we look for robust disclosure in a company’s proxy statement which assures shareholders that they will be afforded the same rights and opportunities to participate as they would at an in-person meeting. Beginning in 2019, however, Glass Lewis will generally recommend voting against members of the governance committee of a board where the board is planning to hold a virtual-only shareholder meeting and the company does not provide such disclosure.

## DIRECTOR COMMITMENTS

While there is no change to our director overboarding policy, we have clarified our approach to evaluating outside commitments of directors who serve in executive roles other than CEO (e.g., executive chair). When determining whether to apply our limit of two total board memberships for public executives, we will evaluate the specific duties and responsibilities of their executive role in addition to the company’s disclosure regarding that director’s time commitments.

## PROXY ACCESS

Beginning in 2017, Glass Lewis reviewed a number of shareholder proposals requesting that Canadian companies adopt U.S.-style proxy access. We have clarified in our guidelines that when these resolutions are proposed at companies that are outside of the United States, Glass Lewis will review such proposals on a case-by-case basis.

We will carefully examine the regulatory landscape within the country in question in order to assess if existing proxy access rights are sufficient or preferable to those requested by the proposal. In instances where we believe that existing laws, policies or regulations either provide shareholders with adequate proxy access rights or would prohibit a company’s adoption of the requested provision, we will recommend that shareholders vote against such proposals. However, we will continue to carefully monitor how other companies within the target company’s market are responding to issues related to proxy access as well as any regulatory changes that may affect the manner in which shareholders may access management’s proxy and will make our voting recommendations accordingly.

## PAY FOR PERFORMANCE

While there is no change to our pay-for-performance model, we have added clarification regarding the Glass Lewis grading system. Consistent with previous years, our pay-for-performance grades guide our evaluation of compensation committee effectiveness, and we generally recommend voting against compensation committee members at companies with a pattern of failing our pay-for-performance analysis. Unlike a school letter grade, however, a “C” does not indicate a significant lapse; rather, a “C” in the Glass Lewis grade system identifies companies where the pay and performance percentile rankings relative to peers are generally aligned.

## MARKET OVERVIEW

Each territory and province in Canada is responsible for its own securities regulation. There is no federal regulatory agency like in many markets, such as the Securities and Exchange Commission in the United States. Most provincial regulatory authorities, however, use as a guide the rulemaking of the Ontario Securities Commission (“OSC”), which oversees the Toronto Stock Exchange (“TSX”) and administers and enforces the provincial Securities Act, the Commodities Futures Act and certain provisions of the Canada Business Corporations Act (“CBCA”). These acts set out the OSC’s authority to develop and enforce rules that help safeguard investors, deter misconduct and foster fair and efficient capital markets and confidence throughout Canadian markets. In addition, the TSX Company Manual provides a set of unified listing requirements to which issuers must adhere.

The Canadian Securities Administrators (“CSA”) is an umbrella organization of Canada’s provincial and territorial securities regulators who work collaboratively to improve, coordinate and harmonize regulation of the Canadian capital markets. The CSA regulates the securities markets through policies set out in a number of multilateral or national instruments. The 13 provincial regulatory bodies in Canada operate under a “passport” system, whereby each has agreed to adopt the decisions made by other agencies. While the OSC is not technically a part of the passport system, the 12 other agencies have agreed to abide by its decisions. The OSC continues to separately analyze decisions made by the other regulatory bodies.

Many Canadian market rules are similar to U.S. corporate governance legislation; however, contrary to the U.S. “rules-based” approach, the Canadian “principles-based” approach requires companies to publicly disclose the extent of their compliance with best practices and to describe the procedures they have implemented to meet each principle. In the wake of the global financial crisis, there has been a push to replace the various existing provincial bodies with a single national securities regulator. In 2010, the finance minister released a draft Canadian Securities Act intended to underlie the unified structure; however, concerns that provincial rights would be eroded by the expansion of federal power were raised and in December 2011 the Supreme Court ruled that the single regulatory regime would be unconstitutional.

# A Board of Directors that Serves the Interests of Shareholders

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## ELECTION OF DIRECTORS

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favor of governance structures that will drive performance, create shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are (i) independent, (ii) have directors with diverse backgrounds, (iii) have a record of positive performance, and (iv) have members with a breadth and depth of experience.

## SLATE ELECTIONS

A diminishing minority of companies continue to elect board members as a slate, whereby shareholders are unable to vote on the election of each individual director, but rather may only vote for – or withhold votes from – the board as a whole.

Although the TSX listing rules prevents the use of slates for most Canadian companies, those traded on alternate exchanges such as the TSX Venture Exchange or Canadian National Stock Exchange are not required to comply. As a result, Glass Lewis will continue to provide recommendations for slates or for each individual director, as applicable. When we recommend voting for a slate but have identified concerns with individual directors, we will note the concerns in our analysis of the board.

Glass Lewis views the use of slate elections as a significant hindrance to the director election process that results in substantially reduced individual accountability. Therefore, when reviewing a slate election, if significant concerns<sup>1</sup> exist concerning any of the nominees, we may recommend withholding votes from the entire slate. However, when our concerns are limited to poor attendance or an excessive number of public company directorships or audit committee memberships, and the aggregate number of directors with these issues represent less than one-third of the total board, we will recommend that shareholders vote for the entire slate of directors.

## INDEPENDENCE

The independence of directors, or lack thereof, is ultimately demonstrated through their decisions. In assessing the independence of directors, we will take into consideration whether a director has a track record indicative of making objective decisions. Ultimately, we believe the determination of a director's independence must take into consideration his/her compliance with the applicable listing requirements on independence, as well as his/her past decisions.

We look at each individual on the board and examine his or her relationships with the company, its associated entities and executives, and other board members. The purpose of this inquiry is to determine whether pre-existing personal, familial or such financial relationships (apart from compensation as a director) are likely to impact the decisions of that board member. We believe the existence of personal, familial or financial

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<sup>1</sup> Such concerns generally relate to: (i) the presence of non-independent directors on a committee; (ii) the absence of an independent chair/lead director or compensation committee; (iii) an insufficiently independent board; (iv) excessive non-audit fees paid to the company's auditor; or (v) significant related-party transactions.

relationships make it difficult for a board member to put the interests of the shareholders above personal interests.

To that end, we classify directors in three categories based on the type of relationships they have with the company:

**Independent Director** — A director is independent if s/he has no direct or indirect material<sup>2</sup> financial or familial<sup>3</sup> connections with the company,<sup>4</sup> its executives, its independent auditor or other board members, except for service on the board and the standard fees paid for that service. Employee relationships that have existed within the past five years and other relationships that have existed within the three years prior to the inquiry are usually considered to be “current” for purposes of this test. However, Glass Lewis does not apply the five-year look-back period to directors who have previously served as executives of the company on an interim basis for less than one year.

**Affiliated Director** — A director is affiliated if s/he has a material, financial, familial or other relationship with the company, its independent auditor or its executives, but is not an employee of the company. This includes directors whose primary employers have a material financial relationship with the company, as well as those who own or control at least 20% of the company’s voting power.<sup>5</sup> We note that in every instance in which a company classifies one of its directors as non-independent, that director will be classified as an affiliate by Glass Lewis.<sup>6</sup>

**Inside Director** — An inside director is one who simultaneously serves as a director and as an employee of the company. This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.

## VOTING RECOMMENDATIONS ON THE BASIS OF INDEPENDENCE

Glass Lewis believes that a board will most effectively perform the oversight necessary to protect the interests of shareholders if it is independent. In general, at least a majority of a board should consist of independent directors.<sup>7</sup> However, Glass Lewis believes boards of companies in the S&P/TSX Composite Index should have a greater level of independence, reflecting both these companies’ size and best practice in Canada. Therefore, we will expect such companies’ boards to be at least two-thirds independent. Further, for venture-listed issuers, we apply a more lenient standard, requiring boards to have at least two independent directors, representing no less than one-third of the board. In the event that a board fails to meet these thresholds, we typically recommend shareholders withhold their votes from some of the inside and/or affiliated directors in order to satisfy these independence standards.

In the case of a staggered board, if the affiliates or insiders who we believe should be removed from the board are not standing for election, we will express our concerns about those directors; however, we will not recommend shareholders withhold their votes from the affiliates or insiders who are up for election just to achieve sufficient overall board independence.

<sup>2</sup> “Material” as used herein means a relationship where the dollar value exceeds: (i) C\$50,000 (C\$25,000 for venture firms), or where no amount is disclosed, for directors who personally receive compensation for a service they have agreed to perform for the company, outside of their service as a director, including professional or other services; (ii) C\$100,000 (C\$50,000 for venture firms), or where no amount is disclosed, for those directors employed by a professional services firm such as a law firm, investment bank or consulting firm where the firm is paid for services but not the individual directly (see section on TSX Venture Companies for exceptions). This dollar limit would also apply to charitable contributions to schools where a board member is a professor, or charities where a board member serves on the board or is an executive, or any other commercial dealings between the company and the director or the director’s firm; (iii) 1% of either company’s consolidated gross revenue for other business relationships (e.g., where the director is an executive officer of a firm that provides or receives services or products to or from the company).

<sup>3</sup> “Familial” as used herein includes a person’s spouse, parents, children, siblings, grandparents, uncles, aunts, cousins, nieces and nephews, in-laws, and anyone (other than domestic employees) who share such person’s home.

<sup>4</sup> “Company” includes any parent or subsidiary in a consolidated group with the company or any entity that merged with, was acquired by, or acquired the company.

<sup>5</sup> The CBCA stipulates that an associate of a person means (among other things) a corporate body or person that beneficially owns or controls, directly or indirectly, shares or securities currently convertible into shares carrying more than 10% of the voting rights.

<sup>6</sup> If the reason for a director’s non-independent status cannot be discerned from the company’s documents, we will footnote the director in the board table as “Not considered independent by the board.” In all other cases where the director is considered affiliated or is an insider, we will footnote the reasons or circumstances for the director’s status.

<sup>7</sup> National Instrument 58-201 — Effective Corporate Governance.

We are firmly committed to the belief that only independent directors should serve on a company's audit, compensation and nominating and/or governance committees. As such, we typically recommend that shareholders withhold their votes from any affiliated or inside director seeking appointment to these committees; however, we allow for exceptions to this rule, including for controlled companies and firms listed on the TSX Venture Exchange, as discussed below.

## PERFORMANCE

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We look at the performance of these individuals as directors and executives of the company and of other companies where they have served.

We find that a director's past conduct is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred serving on the boards of companies with similar problems.

## VOTING RECOMMENDATIONS ON THE BASIS OF PERFORMANCE

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with records of poor performance, inadequate risk oversight, excessive compensation, audit- or accounting-related issues, and/or other indicators of mismanagement or actions against the interests of shareholders. We will reevaluate such directors based on, among other factors, the length of time passed since the incident giving rise to the concern, shareholder support for the director, the severity of the issue, the director's role (e.g., committee membership), director tenure at the subject company, whether ethical lapses accompanied the oversight lapse, and evidence of strong oversight at other companies.

Likewise, we examine the backgrounds of those who serve on key board committees to ensure that they have the required skills and diverse backgrounds to make informed judgments about the subject matter for which the committee is responsible.

We believe shareholders should avoid electing directors who have a record of not fulfilling their responsibilities to shareholders at any company where they have held a board or executive position. We typically recommend voting against:

1. A director who fails to attend a minimum of 75% of board meetings and/or committee meetings in the absence of a reasonable explanation for their poor attendance record.<sup>8</sup>
2. A director who is also the CEO of a company where a serious and material restatement has occurred after the CEO had previously certified the pre-restatement financial statements.<sup>9</sup>
3. A director who has received two against recommendations from Glass Lewis for identical reasons within the prior year at different companies (the same situation must also apply at the company being analyzed).
4. A director who exhibits a pattern of poor oversight in the areas of executive compensation, risk management or director recruitment/nomination.

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<sup>8</sup> However, where a director has served for less than one full year, we will typically not recommend voting against for failure to attend 75% of meetings. Rather, we will note the poor attendance with a recommendation to track this issue going forward. We will also refrain from recommending to vote against directors when the proxy discloses that the director missed the meetings due to serious illness or other extenuating circumstances.

<sup>9</sup> National Instrument 52-109 requires the certification of all financial filings by each the CEO and CFO.

## BOARD RESPONSIVENESS TO A SIGNIFICANT SHAREHOLDER VOTE

Glass Lewis believes that any time 20% or more of shareholders vote contrary to the recommendation of management, the board should demonstrate some level of engagement and responsiveness to address the

shareholder concerns. These include instances when 20% or more of shareholders: (i) withhold votes from (or vote against) a director nominee; (ii) vote against a management-sponsored proposal; or (iii) vote for a shareholder proposal. In our view, a 20% threshold is significant enough to warrant a close examination of the underlying issues and an evaluation of whether or not the board responded appropriately following the vote, particularly in the case of a compensation or director election proposal. While the 20% threshold alone will not automatically generate a negative vote recommendation from Glass Lewis on a future proposal (e.g., to recommend against a director nominee, against a say-on-pay proposal, etc.), it may be a contributing factor to our recommendation to vote against management's recommendation in the event we determine that the board did not respond appropriately.

With regards to companies where voting control is held through a dual-class share structure with disproportionate voting and economic rights, we will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders when determining whether board responsiveness is warranted. Where vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal, we believe the board should demonstrate an appropriate level of responsiveness.

As a general framework, our evaluation of board responsiveness involves a review of publicly available disclosures (e.g., the management information circular, press releases, company website, etc.) released following the date of the company's last annual meeting up through the publication date of our most current Proxy Paper. Depending on the specific issue, our focus typically includes, but is not limited to, the following:

- At the board level, any changes in directorships, committee memberships, disclosure of related party transactions, meeting attendance, or other responsibilities.
- Any revisions made to the company's articles of incorporation, bylaws or other governance documents.
- Any press or news releases indicating changes in, or the adoption of, new company policies, business practices or special reports.
- Any modifications made to the design and structure of the company's compensation program.

Our Proxy Paper analysis will include a case-by-case assessment of the specific elements of board responsiveness that we examined along with an explanation of how that assessment impacts our current vote recommendations.

## SEPARATION OF THE ROLES OF CHAIR AND CHIEF EXECUTIVE

Glass Lewis believes that separating the roles of corporate officers and the board chair is typically a better governance structure than a combined executive/chair position.<sup>10</sup> The role of executives is to manage the business on the basis of the course charted by the board. Executives should report to the board regarding their performance in achieving goals previously set by the board. This process becomes much more complicated when management chairs the board.

Presumably the influence of any chief executive with his/her board will be considerable. A chief executive should be able to set the strategic course for the company, with the blessing of the board, and the board should enable the chief executive to carry out his/her vision for accomplishing the company's objectives.

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<sup>10</sup> National Instrument 58-201 states that the chair of the board should be an independent director and that where this is not appropriate, an independent director should be appointed to act as "lead director." Either an independent chair or an independent lead director should act as the effective leader of the board and ensure that the board's agenda will enable it to successfully carry out its duties.

Failure to achieve this objective should lead the board to replace that chief executive with someone in whom it has greater confidence.

It can become difficult for a board to fulfill its roles as overseer and policy-setter when the chief executive/chair controls the agenda and the discussion in the boardroom. A combination of these roles generally provides chief executives with leverage to entrench their position, leading to longer-than-optimal terms, fewer checks

on management, less scrutiny of the operation of the business and increased limitations on independent, shareholder focused goal-setting by the board.

We view an independent chair as better able to oversee the executives of the company and set a pro-shareholder agenda without the management conflicts that a chief executive or other insiders often face. This, in turn, leads to a more proactive and effective board of directors that is looking out for the interests of

shareholders above all else. We will recommend shareholders withhold votes from the nominating/governance committee chair when a board does not have some established form of independent leadership.

We typically do not recommend that shareholders withhold votes from chief executives who chair the board. However, we generally encourage our clients to support a separation between the roles of board chair and chief executive whenever that question is posed in a proxy, as we believe such a governance structure is in the best long-term interests of the company and its shareholders.

Furthermore, Glass Lewis strongly supports the existence of an independent presiding or lead director with the authority to set the agenda for meetings and lead sessions outside the presence of the insider chair.

## BOARD COMMITTEES

### THE ROLE OF A COMMITTEE CHAIR

Glass Lewis believes that a designated committee chair maintains primary responsibility for the actions of his or her respective committee. As such, many of our committee-specific vote recommendations reference the applicable committee chair rather than the entire committee (depending on the severity of the issue). However, in cases where we would ordinarily recommend voting against a committee chair but one has not been appointed or disclosed, we apply the following general rules, which apply throughout our guidelines:

- If there is no committee chair, we recommend voting against the longest-tenured committee member or, if the longest-serving committee member cannot be determined, the longest-serving board member serving on the committee (i.e., in either case, the “senior director”);
- If there is no committee chair, but multiple senior directors serving on the committee, we recommend voting against one, both (or all) such senior directors as applicable.

In our view, companies should clearly disclose which director is charged with overseeing each committee. In cases where this simple framework is ignored and a reasonable analysis cannot determine which committee member is the designated leader, we believe shareholder action against the longest serving committee member(s) is warranted. To be clear, this only applies in cases where we would ordinarily recommend voting against the committee chair but no such position exists or there is no designated director in such role.

When we would ordinarily recommend that shareholders vote against the committee chair but that committee does not exist, we will instead recommend that shareholders vote against the non-executive chair, or in the absence thereof, the longest-serving non-executive director on the board. Similarly, when we would otherwise recommend that shareholders vote against the board chair for a perceived governance failure, but the chair either cannot be identified or serves as an executive, we will recommend that shareholders vote against the senior non-executive member of the board.

## AUDIT COMMITTEE PERFORMANCE

Audit committees play an integral role in overseeing the financial reporting process because “[v]ibrant and stable capital markets depend on, among other things, reliable, transparent, and objective financial information to support an efficient and effective capital market process. The vital oversight role audit committees play in the process of producing financial information has never been more important.”<sup>11</sup>

When assessing an audit committee’s performance, we are aware that this committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or other disclosures provided to investors. Rather, the audit committee monitors and oversees the processes and procedures that management and auditors perform. The 1999 Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees stated it best:

*“A proper and well-functioning system exists, therefore, when the three main groups responsible for financial reporting — the full board including the audit committee, financial management including the internal auditors, and the outside auditors — form a ‘three legged stool’ that supports responsible financial disclosure and active participatory oversight. However, in the view of the Committee, the audit committee must be ‘first among equals’ in this process, since the audit committee is an extension of the full board and hence the ultimate monitor of the process.”*

## STANDARDS FOR ASSESSING THE AUDIT COMMITTEE

For an audit committee to function effectively on investors’ behalf, it must include members with sufficient knowledge to diligently carry out their responsibilities. In its audit and accounting recommendations, the Conference Board Commission on Public Trust and Private Enterprise said “members of the audit committee must be independent and have both knowledge and experience in auditing financial matters.”<sup>12</sup>

Glass Lewis generally assesses audit committees against the decisions they make with respect to their oversight and monitoring role. Shareholders should be provided with reasonable assurance as to the material accuracy of financial statements based on: (i) the quality and integrity of the documents; (ii) the completeness of disclosures necessary for investors to make informed decisions; and (iii) the effectiveness of internal controls. The independence of the external auditors and the results of their work provide useful information for assessing the audit committee.

We are skeptical of audit committees that have members who lack expertise as a certified public accountant, CFO or corporate controller of similar experience. While we will not necessarily vote against members of an audit committee when such expertise is lacking, we are more likely to vote against committee members when a problem such as a restatement occurs and such expertise is lacking.

When assessing the decisions and actions of an audit committee, we typically defer judgment to its members; however, we recommend withholding votes from the following members under these circumstances:

1. All members of the audit committee who served on the committee at the time of the audit, if audit and audit-related fees total less than 50% of the fees billed by the auditor.
2. All members of the audit committee who sit on an excessive number of public company audit committees.<sup>13</sup>

<sup>11</sup> “Audit Committee Effectiveness – What Works Best.” PricewaterhouseCoopers. The Institute of Internal Auditors Research Foundation. 2005.

<sup>12</sup> Commission on Public Trust and Private Enterprise. The Conference Board. 2003.

<sup>13</sup> For audit committee members of TSX-listed companies, we generally consider three audit committee memberships to be a reasonable limit, and four for directors with demonstrable financial expertise such as a former CFO. For audit committee members of companies listed on the TSX Venture exchange, we generally consider four audit committees to be a reasonable limit, and five for directors with financial expertise. Factors that we will consider include company size, their geographical distribution and an audit committee member’s level of expertise and overall commitments; ultimately we will evaluate a director’s level of commitment on a case-by-case basis.

3. The audit committee chair if the company has not disclosed a breakdown of fees paid to the auditor for the past fiscal year.
4. The audit committee chair if the committee did not put the selection of the auditor up for shareholder approval.<sup>14</sup>
5. The audit committee chair if there is not at least one member who is financially literate, as required by the CSA.
6. The audit committee chair if the audit committee consisted of fewer than three members for the majority of the fiscal year (see section on venture firms for exceptions).
7. All members of the audit committee who served at a time when the company failed to report or have its auditors report material weaknesses in internal controls.
8. All members of the audit committee who served at a time when financial statements had to be restated due to negligence or fraud.
9. All members of the audit committee if the company has repeatedly failed to file its financial reports in a timely fashion.
10. All members of the audit committee if the committee re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
11. All members of the audit committee who served at a time when accounting fraud occurred in the company.
12. All members of the audit committee if recent non-audit fees have included charges for services that are likely to impair the independence of the auditor.<sup>15</sup>
13. All members of the audit committee if non-audit fees include charges for tax services for senior executives of the company, or include services related to tax avoidance or tax shelter schemes.
14. All members of the audit committee if options have recently been backdated, and: (i) there are inadequate internal controls in place, or, (ii) there was a resulting restatement and disclosures indicate there was a lack of documentation with respect to option grants.
15. All members of the audit committee who served since the date of the company's last annual meeting, and when, since the last annual meeting, the company has reported a material weakness that has not yet been corrected, or, when the company has an ongoing material weakness from a prior year that has not yet been corrected.

## COMPENSATION COMMITTEE PERFORMANCE

Compensation committees have a critical role in determining the compensation of executives. This includes deciding the basis on which compensation is determined, as well as the amounts and types of compensation to be paid. This process begins with the establishment of employment agreements, including the terms for such items as base pay, pensions and severance arrangements. It is important for compensation arrangements to be based on a company's long-term economic performance and returns to shareholders.

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<sup>14</sup> The CBCA requires the selection of a company's auditor to be approved by shareholders annually.

<sup>15</sup> Such services include: (i) bookkeeping or other services related to the accounting records or financial statements of the audit client; (ii) financial information systems design and implementation; (iii) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (iv) actuarial services; (v) internal audit outsourcing services; (vi) management functions or human resources; (vii) broker or dealer, investment adviser, or investment banking services; (viii) legal services and expert services unrelated to the audit; and (ix) any other service that the board determines, by regulation, is impermissible.

Compensation committees are also responsible for overseeing the transparency of compensation. This oversight includes disclosure of various compensatory elements, including the overall disclosure of arrangements, pay-for-performance matrices and the use of compensation consultants. It is important that investors be provided clear and complete disclosure of the significant terms of compensation arrangements in order to help them reach informed opinions regarding the compensation committee's actions.

Finally, compensation committees are responsible for the oversight of internal controls in the executive compensation process. This duty includes supervising controls over gathering information used to determine compensation, establish equity award plans, and grant equity awards. Deficient controls can contribute to conflicting information being obtained, for example, through the use of non-objective consultants. Deficient

controls can also contribute to the granting of improper awards, such as backdated or spring-loaded options, or unmerited bonuses.

Central to understanding the actions of a compensation committee is a careful review of the Compensation Discussion and Analysis ("CD&A") report included in each company's proxy. We review the CD&A in our evaluation of the overall compensation practices of a company, as overseen by the compensation committee. The CD&A is also integral to the evaluation of compensation proposals at companies, such as management-submitted advisory compensation vote proposals, which allow shareholders to vote on the compensation paid to a company's top executives. For more information on our approach to executive compensation, please refer to Section III — The Link Between Compensation and Performance.

We may recommend withholding votes from the following compensation committee members under the following circumstances:

1. All members of a compensation committee during whose tenure the committee failed to address shareholder concerns following majority shareholder opposition to a say-on-pay proposal in the previous year. Where the proposal was approved but there was a significant shareholder vote (i.e., greater than 20% of votes cast) against the say-on-pay proposal in the prior year, if the board did not respond sufficiently to the vote including actively engaging shareholders on this issue, we will also consider recommending voting against the compensation committee chair or all members of the compensation committee, depending on the severity and history of the compensation problems and the level of shareholder opposition.
2. The compensation committee chair if the CD&A fails to provide a reasonable level of disclosure that allows shareholders to fully comprehend executive compensation policies or practices.
3. All members of the compensation committee who are up for election and served when the company failed to align pay with performance if shareholders are not provided with an advisory vote on executive compensation at the annual meeting.<sup>16</sup>
4. All members of the compensation committee (from the relevant time period) if the company has entered into excessive employment agreements and/or severance arrangements.
5. All members of the compensation committee if performance goals were changed (e.g., lowered) when employees failed or were unlikely to meet original goals, or if performance-based compensation was paid despite goals not being attained.

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<sup>16</sup> If a company provides shareholders with a say-on-pay proposal, we will initially only recommend voting against the company's say-on-pay proposal and will not recommend voting against the members of the compensation committee unless there is a pattern of failing to align pay and performance and/or the company exhibits egregious compensation practices. However, if the company repeatedly fails to align pay and performance, we will then recommend against the members of the compensation committee in addition to recommending voting against the say-on-pay proposal. For cases in which the disconnect between pay and performance is marginal and the company has outperformed its peers, we will consider not recommending against compensation committee members.

6. All members of the compensation committee if excessive employee perquisites and benefits were allowed.
7. The compensation committee chair if the compensation committee did not meet during the year.

We also believe that any company that pays its executives should maintain a committee to provide the necessary oversight for related matters. Therefore, we will usually recommend that shareholders withhold votes from the board chair or senior non-executive director when this key committee has not been established.

## NOMINATING AND GOVERNANCE COMMITTEE PERFORMANCE

The nominating and governance committee, as the agent for shareholders, is responsible for the board's governance of the company and its executives. In performing this role, the board is responsible and accountable for the selection of objective and competent directors. It is also responsible for providing leadership on governance policies adopted by the company, such as the implementation of shareholder proposals that have received a majority vote. In Canada, the committees that are charged with fulfilling these roles may be combined or separated. As such, our voting recommendations may fluctuate depending on the specific duties charged to each committee.

Consistent with Glass Lewis' philosophy that boards should have diverse backgrounds and members with a breadth and depth of relevant experience, we believe that nominating and governance committees should consider diversity when making director nominations within the context of each specific company and its industry. In our view, shareholders are best served when boards make an effort to ensure a constituency that is not only reasonably diverse on the basis of age, race, gender and ethnicity, but also on the basis of geographic knowledge, industry experience, board tenure and culture.

Regarding the nominating committee, we may recommend that votes be withheld from the following members under these circumstances:

1. All members of the nominating committee when the committee nominated or re-nominated an individual who had a significant conflict of interest or whose past actions demonstrated a lack of integrity or an inability to represent shareholder interests.
2. The nominating committee chair if the nominating committee did not meet during the year.
3. The nominating committee chair and/or all members of the committee when the number of directors on the board is more than 20 or fewer than five directors (or four for venture exchange listed issuers).
4. The nominating committee chair of a venture firm when there are fewer than two independent directors on the board.<sup>17</sup>
5. The nominating committee chair, when a director who did not receive support from a majority of voting shares in the previous election was allowed to remain on the board and, further, the issues that raised shareholder concern were not addressed.<sup>18</sup>
6. The chair of the nominating committee where the board's failure to ensure the board has directors with relevant experience, either through periodic director assessment or board refreshment, has contributed to a company's poor performance.

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<sup>17</sup> In the absence of a chair, we will recommend that shareholders withhold votes from the senior member of this committee or, in the absence of this committee, the board chair. In the absence of a board chair, we will recommend withholding votes from the senior non-executive director.

<sup>18</sup> Considering that shareholder discontent clearly relates to the director who received a greater than 50% against vote rather than the nominating chair, we review the validity of the issue(s) that initially raised shareholder concern, follow-up on such matters, and only recommend voting against the nominating chair if a reasonable analysis suggests that it would be most appropriate. In rare cases, we will consider recommending against the nominating chair when a director receives a substantial (i.e., 20% or more) vote against based on the same analysis.

We may recommend withholding votes from the following members of the governance committee in these circumstances:

1. The governance committee chair<sup>19</sup> when the board chair is not independent and an independent lead or presiding director has not been appointed.
2. All members of the governance committee who served at a time when the board failed to implement a shareholder proposal approved by shareholders with a direct and substantial impact on shareholders and their rights.
3. All members of the governance committee when the board fails to adopt a majority voting policy.<sup>20</sup>
4. The governance committee chair when the board has provided poor disclosure on key issues, such as the identity of its chair, related-party transactions or other information necessary for shareholders to properly evaluate the board.
5. The governance committee chair when the board has failed to disclose detailed voting results from the previous annual meeting.

## OTHER CONSIDERATIONS

### DIRECTOR COMMITMENTS

We believe that directors should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted director can pose a material risk to a company's shareholders, particularly during periods of crisis. In addition, recent research indicates that the time commitment associated with being a director has been on a significant upward trend in the past decade. As a result, we generally recommend that shareholders vote against a director who serves as an executive officer of any public company while serving on more than two public company boards and any other director who serves on more than five public company boards.<sup>21</sup>

Because we believe that executives will primarily devote their attention to executive duties, we generally will not recommend that shareholders vote against overcommitted directors at the companies where they serve as an executive.

When determining whether a director's service on an excessive number of boards may limit the ability of the director to devote sufficient time to board duties, we may consider relevant factors such as the size and location of the other companies where the director serves on the board, the director's board roles at the companies in question, whether the director serves on the board of any large privately-held companies, the director's tenure on the boards in question, and the director's attendance record at all companies. In the case of directors who serve in executive roles other than CEO (e.g., executive chair), we will evaluate the specific duties and responsibilities of that role in determining whether an exception is warranted.

We may also refrain from recommending against certain directors if the company provides sufficient rationale for their continued board service. The rationale should allow shareholders to evaluate the scope of the directors' other commitments, as well as their contributions to the board including specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors. We will also generally refrain from recommending to vote against a director who serves on an excessive number of boards within a consolidated group of companies or a director that represents a firm whose sole purpose is to manage a portfolio of investments which include the company.

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<sup>19</sup> In the absence of a chair, we will recommend that shareholders withhold votes from the senior member of this committee or, in the absence of this committee, the senior non-executive director.

<sup>20</sup> Only applies to companies listed on the Toronto Stock Exchange.

<sup>21</sup> Given the reduced time commitment and after consideration of all relevant circumstances (including attendance, company size, and a director's overall expertise and performance), we generally permit directors at TSX Venture firms to sit on up to nine boards (refer to "TSX Venture Companies" section for further information).

## CONFLICTS OF INTEREST

In addition to the above three key characteristics we analyze in evaluating board members — independence, performance and experience — we also consider other issues in making voting recommendations.

Irrespective of the overall presence of independent directors on the board, we believe that a board should be wholly free of people who have identifiable conflicts of interest. Accordingly, we recommend shareholders withhold votes from the following types of affiliated or inside directors in nearly all circumstances:

1. A CFO currently serving on the board. In our view, the CFO holds a unique position relative to financial reporting and disclosure to shareholders. Given the critical importance of financial disclosure and reporting, we believe the CFO should report to the board and not be a member of it.
2. A director, or an immediate family member of a director, who provided the company with material professional services at any time during the past year.<sup>22</sup> These material services may include consulting or financial services to the company. Directors who receive compensation from the company will have to make unnecessarily complicated decisions that may pit their interests against those of the shareholders they serve.<sup>23</sup>
3. A director, or an immediate family member of a director, who engages in, or receives benefits from, commercial deals, including perquisite type grants from the company, which we believe may force the director in question to make unnecessarily complicated decisions that pit his/her interests against those of shareholders. Given the pool of director talent and the limited number of directors on any board, we believe shareholders are best served by directors who are independent of such relationships.
4. A director who has interlocking directorships with one of the company's executives. Top executives serving on each other's boards creates an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.

## BOARD SIZE

While we do not believe that there is a universally applicable optimum board size, we do believe that boards should have a minimum of five directors in order to ensure that there is a sufficient diversity of views and breadth of experience in every decision the board makes. At the other end of the spectrum, we believe that boards with more than 20 directors will typically suffer under the weight of “too many cooks in the kitchen” and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices makes it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

To that end, we typically recommend withholding votes from the chair of the nominating and/or governance committee at boards with fewer than five directors (or the board chair, in the absence of this committee), or four directors for venture issuers. For boards consisting of more than 20 directors, we typically recommend withholding votes from the nominating committee chair (or governance committee, in the absence of a nominating committee).<sup>24</sup>

## EXCEPTIONS FOR RECENT IPOs

We believe companies that have recently completed an initial public offering (“IPO”) should be allowed adequate time to fully comply with marketplace listing requirements as well as to meet basic corporate governance standards. We believe a one-year grace period immediately following the date of a company's

<sup>22</sup> See definition of “material” under Independence.

<sup>23</sup> We provide an exception when companies structure compensation so that executives are paid as consultants rather than provided with salaries, as is common practice among venture companies.

<sup>24</sup> Certain exceptions may be made for large banks on a case-by-case basis.

IPO is sufficient time for most companies to comply with all relevant regulatory requirements and to meet such corporate governance standards. Except in egregious cases, Glass Lewis refrains from issuing voting recommendations on the basis of corporate governance best practices (e.g., board independence, committee membership and structure, meeting attendance, etc.) during the one-year period following an IPO.

## DUAL-LISTED COMPANIES

For those companies whose shares trade on exchanges in multiple countries, and which may seek shareholder approval of proposals in accordance with varying exchange- and country-specific rules, we will apply the governance standards most relevant in each situation. We will consider a number of factors in determining which Glass Lewis country-specific policy to apply, including but not limited to: (i) the corporate governance structure and features of the company including whether the board structure is unique to a particular market; (ii) the nature of the proposals; (iii) the location of the company's primary listing, if one can be determined; (iv) the regulatory/governance regime that the board is reporting against; and (v) the availability and completeness of the company's proxy filings.

## ENVIRONMENTAL AND SOCIAL RISK OVERSIGHT

Companies face significant financial, legal and reputational risks resulting from poor environmental and social practices, or negligent oversight thereof. Therefore, Glass Lewis views the identification, mitigation and management of environmental and social risks as integral components when evaluating a company's overall risk exposure. We believe boards should ensure that management conducts a complete risk analysis of company operations, including those that have environmental and social implications. Directors should monitor management's performance in managing and mitigating these environmental and social risks in order to eliminate or minimize the risks to the company and its shareholders. In cases where the board or management has failed to sufficiently identify and manage a material environmental or social risk that did or could negatively impact shareholder value, we will recommend shareholders vote against directors responsible for risk oversight in consideration of the nature of the risk and the potential effect on shareholder value.

## TSX VENTURE EXCHANGE COMPANIES

The TSX Venture Exchange is a marketplace for emerging companies with generally fewer resources and employees than firms trading on the main market of the TSX. Venture firms usually follow more lenient governance standards, and while we make several exceptions to our independence standards for them, we still expect venture companies to maintain a minimum degree of director independence on their boards and central committees.

The independence exceptions we make for venture firms are as follows:

1. We do not require venture firms to meet the same independence thresholds we apply for companies listed on the main market of the TSX. We believe such companies can more reasonably be expected to have at least two independent directors, as long as they represent at least one-third of the board.<sup>25</sup>
2. Although the TSX only requires the audit committees of venture firms to be majority independent, we believe they should be entirely independent, with at least two members.
3. While the TSX does not require venture firms to maintain a compensation committee, we believe any public firm that pays its executives should have a compensation committee to oversee such payments. For venture firms, this committee should be majority independent, with no insiders.<sup>26</sup>

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<sup>25</sup> TSX Venture Exchange Policy 3.1 stipulates that venture firms have at least two independent directors. However, we believe that the two independent directors should comprise at least one-third of the entire board in order to ensure an effective level of independent oversight. When this is not the case, we generally recommend withholding votes from non-independent directors or the board chair or senior non-executive director, as applicable.

<sup>26</sup> We generally recommend withholding votes from the board chair when a company does not have a standing compensation committee. In the absence of a chair, we recommend withholding votes from the senior non-executive director.

4. Nominating/governance committees, if they exist, should consist of a majority of independent directors.

Also, we believe venture firms should maintain a board of at least four members, as opposed to the five-member minimum standard applied to other TSX companies.<sup>27</sup>

Further, as these smaller companies typically require less time and action from their boards than their larger counterparts, we will generally permit directors at venture firms to serve on up to nine boards. Factors which we will consider include company size and a director's overall attendance record and expertise. We note that a large number of directors at venture companies tend to serve on multiple public company boards, but given that many of these firms could benefit from the guidance and oversight provided by an experienced and knowledgeable board member, we believe that a higher threshold is appropriate.

We also note that directors often serve on a mix of TSX and venture boards. In these cases we will apply a case-by-case approach to evaluating the director's commitments in the aggregate.

Note that for other small exchanges, such as the Canadian Securities Exchange ("CSE"), we will apply our TSX Venture guidelines.

## CONTROLLED COMPANIES

For controlled companies, we provide an exception to our independence standards. The board of directors' function is to protect the interests of shareholders; however, when a single individual or entity owns more than 50% of the voting shares, the interests of the majority of shareholders are the interests of that entity or individual. Consequently, Glass Lewis does not recommend withholding votes from boards whose composition reflects the makeup of the shareholder population. In other words, affiliated directors and insiders who are associated with the controlling entity are not subject to our standard independence thresholds.

However, we believe that there should be enough independent directors in order to fairly reflect minority shareholder interests. As such, we would consider, in very limited cases, recommending shareholders withhold votes from certain directors if there is not a sufficient representation of minority shareholder interests on the board.

We make the following exceptions for controlled companies:

1. We do not require controlled companies to meet our standard independence thresholds. So long as the insiders and/or affiliated directors are connected with the controlling entity, we accept the presence of non-independent directors on the board.
2. The compensation, nominating and governance committees do not need to consist solely of independent directors.<sup>28</sup>
3. We believe that controlled companies do not need to have standing nominating and corporate governance committees. Although a committee charged with the duties of searching for, selecting and nominating independent directors can be of benefit to all companies, the unique composition of a controlled company's shareholder base make such a committee both less powerful and less relevant.

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<sup>27</sup> TSX Venture Exchange Policy 3.1 requires all issuers to have at least three directors. However, we do not believe three directors can adequately protect the interests of shareholders.

<sup>28</sup> However, National Instrument 58-201 stipulates that companies must provide additional disclosure to describe the steps taken by the board to ensure that objective nomination and compensation processes are utilized. In the absence of a reasonable justification, we recommend withholding votes from any nominee seeking appointment to these committees, regardless of the company's controlled status.

4. In a similar fashion, controlled companies do not need to have an independent chair or lead director. While we believe an independent director in a position of authority on the board — such as the chair or presiding director — is best able to ensure the proper discharge of the board’s duties, controlled companies serve a unique shareholder population whose voting power ensures the protection of its interests.
5. We do not require controlled companies to adopt a majority voting policy for the election of directors. Although we believe a majority voting policy generally increases board accountability and performance, we understand that this may be irrelevant given the influence a controlling shareholder has on all matters requiring shareholder approval.

We do not make independence exceptions for controlled companies in the case of audit committee membership. We believe audit committees should consist solely of independent directors regardless of the company’s controlled status. The interests of all shareholders must be protected by ensuring the integrity and accuracy of the company’s financial statements. Allowing affiliated directors to discharge the duties of audit oversight could present an insurmountable conflict of interest.<sup>29</sup>

## BOARD RESPONSIVENESS AT DUAL-CLASS COMPANIES

With regards to companies where voting control is held through a dual-class share structure with disproportionate voting and economic rights, we will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders when determining whether board responsiveness is warranted. Where vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal, we believe the board should demonstrate an appropriate level of responsiveness.

## SIGNIFICANT SHAREHOLDERS

Similarly, where an individual or entity holds between 20-50% of a company’s voting power, we will allow for proportional representation on the board and committees (excluding the audit committee) based on the individual or entity’s percentage of ownership.

## TRUSTS AND FUNDS

Investment trusts pool investors’ money and invest in the shares of a wider range of companies than most people could practically invest in themselves. Generally the task of investing is delegated to a professional fund manager. Investment trusts often maintain no permanent employees.

National Instrument 81-107 requires all publicly offered investment funds to have an independent review committee (“IRC”) to oversee decisions involving conflicts of interest faced by the person or company that directs the business, operations and affairs of the investment fund. The manager<sup>30</sup> must appoint each member of an investment fund’s first IRC, and thereafter, the IRC must fill any vacancy that arises.

A member of the IRC is considered independent if the member has no material relationship<sup>31</sup> with the manager, the investment fund, or an entity related to the manager. A current or former independent member of the board of directors of an investment fund, or a former independent member of the board of directors of the manager, may be considered independent; however, it would be unlikely that a current member of the board of directors of a manager could be considered independent. Investment funds may share an IRC with investment funds managed by another manager.

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<sup>29</sup> National Instrument 52-110 provides that, in the case of a controlled company, an audit committee member who sits on the board of directors of an affiliated entity is exempt from the requirement that every audit committee member must be independent, if the member, except for being a director of the company and the affiliated entity, is otherwise independent of the company and the affiliated entity.

<sup>30</sup> A manager is defined as a person or company who directs the business, operations and affairs of an investment fund, and includes a group of members on the board of an investment fund where they act in the capacity of decision-maker. We interpret this term broadly.

<sup>31</sup> A material relationship means a relationship that could reasonably be perceived to interfere with the member’s judgment regarding a conflict of interest.

## POLICIES FOR TRUSTS AND FUNDS

Given the different structure of investment trusts relative to other publicly traded companies, we believe it is appropriate to apply a different set of corporate governance guidelines to such firms. The following is a summary of significant policy differences:

1. Boards may have a minimum of four directors, rather than five.
2. Boards need not maintain standing compensation or nomination committees. However, in the event that a trust does not have a compensation committee, we believe it should disclose the procedures it utilizes to ensure objectivity in the setting of compensation levels. Compensation and nomination committees need not be entirely independent; however, they must consist solely of non-executive directors, a majority of whom are independent.
3. Trusts need not put their auditors up for ratification, unless there was a change of auditor in the previous fiscal year or a change of auditor is expected following the annual general meeting. However, we continue to recommend withholding votes from the chair of the audit committee if fees paid to the external auditor have not been disclosed, or if there are other audit-related issues.

## DECLASSIFIED BOARDS

Glass Lewis favors the repeal of staggered boards in favor of the annual election of directors. We believe staggered boards are less accountable to shareholders than boards elected annually. Furthermore, we feel the annual election of directors encourages board members to focus on shareholder interests.

Empirical studies have shown that the use of staggered boards reduces a firm's value. Further, in the context of hostile takeovers, staggered boards operate as a takeover defense, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.

In our view, there is no evidence to demonstrate that staggered boards improve shareholder returns in a takeover context. Research shows that shareholders are worse off when a staggered board blocks a transaction. A study by a group of Harvard Law professors concluded that companies whose staggered boards prevented a takeover "reduced shareholder returns for targets ... on the order of eight to ten percent in the nine months after a hostile bid was announced."<sup>32</sup> When a staggered board negotiates a friendly transaction, no statistically significant difference in premiums occurs.<sup>33</sup>

We note that staggered boards are extremely rare in Canada and that the TSX Company Manual now requires annual elections. As such, we do not expect staggered boards to be a significant issue going forward.

## BOARD COMPOSITION AND REFRESHMENT

Glass Lewis strongly supports routine director evaluation, including independent external reviews, and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of the director evaluations, as opposed to relying solely on age or tenure limits. When necessary, shareholders can address concerns regarding proper board composition through director elections.

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<sup>32</sup> Lucian Bebchuk, John Coates, Guhan Subramanian, "The Powerful Antitakeover Force of Staggered Boards: Further Findings and a Reply to Symposium Participants," December 2002, page 1.

<sup>33</sup> Id. at 2 ("Examining a sample of seventy-three negotiated transactions from 2000 to 2002, we find no systematic benefits in terms of higher premia to boards that have [staggered structures].").

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. This said, we recognize that in rare circumstances, a lack of refreshment can contribute to a lack of board responsiveness to poor company performance.

On occasion, age or term limits can be used as a means to remove a director for boards that are unwilling to police their membership and enforce turnover. Some shareholders support term limits as a way to force change in such circumstances.

While we understand that age limits can aid board succession planning, the long-term impact of age limits restricts experienced and potentially valuable board members from service through an arbitrary means. We believe that shareholders are better off monitoring the board's overall composition, including its diversity of skill sets, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that don't necessarily correlate with returns or benefits for shareholders.

However, if a board adopts term/age limits, it should follow through and not waive such limits. If the board waives its term/age limits, Glass Lewis will consider recommending shareholders vote against the nominating and/or governance committees, unless the rule was waived with sufficient explanation, such as consummation of a corporate transaction like a merger.

## **BOARD GENDER DIVERSITY**

Glass Lewis recognizes the importance of ensuring that the board is comprised of directors who have a diversity of skills, thought and experience, as such diversity benefits companies by providing a broad range of perspectives and insights.<sup>34</sup> As with previous years, Glass Lewis will continue to closely review the composition of the board and may note as a concern instances where we believe the board lacks representation of diverse director candidates, including those boards which have no female directors.

In 2018, we will not make voting recommendations solely on the basis of the diversity of the board. Rather, it will be one of many considerations we make when evaluating companies' oversight structures. Beginning in 2019, however, Glass Lewis will generally recommend voting against the nominating committee chair of a board that has no female members, or that has not adopted a formal written gender diversity policy. Depending on other factors, including the size of the company, the industry in which the company operates and the governance profile of the company, we may extend this recommendation to vote against other nominating committee members. When making these voting recommendations, we will carefully review a company's disclosure of its diversity considerations and may refrain from recommending shareholders vote against directors of companies outside the S&P/TSX Composite index, or when boards have provided a sufficient rationale for not having any female board members or have disclosed a plan to address the lack of diversity on the board.

## **PROXY ACCESS**

In lieu of running their own contested election, proxy access would not only allow certain shareholders to nominate directors to company boards but the shareholder nominees would be included on the company's ballot, significantly enhancing the ability of shareholders to play a meaningful role in selecting their representatives. Glass Lewis generally supports affording shareholders the right to nominate director candidates to management's proxy as a means to ensure that significant, long-term shareholders have an ability to nominate candidates to the board.

Companies generally seek shareholder approval to amend company bylaws to adopt proxy access in response to shareholder engagement or pressure, usually in the form of a shareholder proposal requesting proxy access, although some companies may adopt some elements of proxy access without prompting. Glass Lewis considers several factors when evaluating whether to support proposals for companies to adopt proxy access including the specified minimum ownership and holding requirement for shareholders to nominate one or more directors, as well as company size, performance and responsiveness to shareholders.

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<sup>34</sup> <http://www.glasslewis.com/wp-content/uploads/2017/03/2017-In-Depth-Report-Gender-Diversity.pdf>.

Beginning in 2017, Glass Lewis reviewed a number of shareholder proposals requesting that Canadian companies adopt U.S.-style proxy access. When these resolutions are proposed at companies that are outside of the United States, Glass Lewis will review such proposals on a case-by-case basis. We will carefully examine the regulatory landscape within the country in question in order to assess if existing proxy access rights are sufficient or preferable to those requested by the proposal. In instances where we believe that existing laws, policies or regulations either provide shareholders with adequate proxy access rights or would prohibit a company's adoption of the requested provision, we will recommend that shareholders vote against such proposals. However, we will continue to carefully monitor how other companies within the target company's market are responding to issues related to proxy access as well as any regulatory changes that may affect the manner in which shareholders may access management's proxy and will make our voting recommendations accordingly.

For a discussion of recent regulatory events in this area, along with a detailed overview of the Glass Lewis approach to Shareholder Proposals regarding Proxy Access, refer to Glass Lewis' Proxy Paper Guidelines for Shareholder Initiatives, available at [www.glasslewis.com](http://www.glasslewis.com).

# Transparency and Integrity in Financial Reporting

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## ALLOCATION OF PROFITS/DIVIDENDS

Unlike many other countries, Canadian companies are not required to submit the allocation of income for shareholder approval, and the board has the sole discretion to determine the amount of any dividends it intends to distribute. However, the CBCA prohibits the allotment of a dividend if there are reasonable grounds for believing that a company would be unable to pay its liabilities as they become due, or if the realizable value of the company's assets would be less than the aggregate of its liabilities and stated capital after payment.

## AUDITOR RATIFICATION

The auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and conduct a thorough analysis of a company's books to ensure that the information provided to shareholders is complete, accurate, fair, and a reasonable representation of a company's financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

Shareholders should demand an objective, competent and diligent auditor who performs at or above professional standards at every company in which the investors hold an interest. As with directors, auditors should be free from conflicts of interest and should avoid situations requiring a choice between the interests of the auditor and the public. Almost without exception, shareholders should be able to annually review an auditor's performance and ratify a board's auditor selection. Additionally, Glass Lewis believes auditor rotation can ensure both the independence of the auditor and the integrity of the audit; we will typically recommend supporting proposals to require auditor rotation when the proposal uses a reasonable period of time (usually not less than 5-7 years) particularly at companies with a history of accounting problems.

## VOTING RECOMMENDATIONS

We generally support management's recommendation regarding the selection of an auditor and granting the board the authority to fix auditor fees, except in cases where we believe the independence of a returning auditor or the integrity of the audit has been compromised.

Some of the reasons why we may not recommend voting in favor of the auditor and/or authorizing the board to set auditor fees include:

- When audit fees and audit-related fees total less than 50% of overall fees.<sup>35</sup>
- When there have been any recent restatements or late filings by the company where the auditor bears some responsibility for the restatement or late filing (e.g., a restatement due to a reporting error).<sup>36</sup>

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<sup>35</sup> We make an exception in cases where the non-audit fees exceed 50% of the total fees as a result of transactions of a one-time nature (e.g., initial public offerings or merger and acquisition transactions).

<sup>36</sup> An auditor does not perform an audit of interim financial statements and accordingly, in general, we do not believe auditors should be opposed for a restatement of interim financial statements, unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

- When the company has aggressive accounting policies.
- When the company has poor disclosure or a lack of transparency in its financial statements.
- When there are other relationships or issues of concern with the auditor that might suggest a conflict between the interests of the auditor and those of shareholders.
- When the company is changing auditors as a result of a disagreement between the company and auditor on a matter of accounting principles or practices, financial statement disclosure or auditing scope or procedures.

In addition, we will generally support a board's decisions to change auditors. We believe that rotating auditors is an important safeguard against the relationship between the auditor and companies becoming too close, resulting in a lack of oversight due to complacency or conflicts of interest. However, we will apply heightened scrutiny in these instances to ensure that there were no significant disagreements between management and the auditor that led to the auditor's resignation.

# The Link Between Compensation and Performance

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Glass Lewis carefully reviews the compensation awarded to senior executives, as we believe that this is an important area in which the board's priorities are revealed. Glass Lewis strongly believes executive compensation should be linked directly with the performance of the business the executive is charged with managing. We typically look for compensation arrangements that provide for a mix of performance-based short- and long-term incentives in addition to fixed pay elements.

## EVALUATION OF EXECUTIVE COMPENSATION AND SAY-ON-PAY

Comprehensive, timely and transparent disclosure of executive pay is critical to allowing shareholders to evaluate the extent to which pay is keeping pace with company performance. When reviewing proxy materials, Glass Lewis examines whether the company discloses the performance metrics used to determine executive compensation. Performance metrics vary significantly between companies and industries and may include a wide variety of financial measures as well as industry-specific performance indicators.

It is rarely in shareholders' interests to disclose competitive data about individual salaries below the senior executive level. Such disclosure could create internal personnel discord that would be counterproductive for the company and its shareholders. While we favor full disclosure for senior executives and we view pay disclosure at the aggregate level (e.g., the number of employees being paid over a certain amount or in certain categories) as potentially useful, we do not believe shareholders need or will benefit from detailed reports about individual management employees other than the most senior executives.

In accordance with National Instrument 51-102, companies are now required to include a Compensation Discussion and Analysis ("CD&A") in each proxy filing, which replaces the previously required Statement of Executive Compensation. The CD&A is intended to enhance disclosure of compensation policies and practices in a uniform format across Canada, as well as provide shareholders with a transparent and comprehensive rationale for executive compensation levels.

We review the CD&A as part of our evaluation of the overall compensation practices of a company. In our evaluation of the CD&A, we examine, among other factors, the following:

1. The extent to which the company has utilized performance goals in determining overall compensation.
2. How clearly the company has disclosed performance metrics and goals, as well as how the metrics and goals were determined, so that shareholders may make an independent determination that goals were met.
3. The extent to which the disclosed performance metrics, targets and goals are demonstrably linked to enhancing company performance.
4. The selected peer group(s), so that shareholders can make a comparison of pay and performance across the appropriate peer group.

5. The terms of executive employment agreements, including the inclusion of single and double trigger change-of-control provisions and “golden parachutes” that result in large guaranteed payouts upon termination of employment.
6. The amount of discretion granted to management or the compensation committee to deviate from defined performance metrics and goals in granting awards.

## SAY-ON-PAY VOTING RECOMMENDATIONS

The practice of approving a company’s compensation reports is standard in many markets and has been a requirement for companies in the United Kingdom and Australia since 2003 and 2005, respectively. In Canada, advisory votes on executive compensation were introduced voluntarily by some companies in 2010 and have been quickly adopted by others, with approximately 160 companies offering their shareholders a “say on pay” in 2015. We believe these proposals should be submitted annually, as they provide an effective mechanism for enhancing transparency in setting executive pay, improving accountability to shareholders and providing for a more effective link between pay and performance.

Glass Lewis applies a highly nuanced approach when analyzing advisory votes on executive compensation. We review each advisory vote on a case-by-case basis, with the belief that each company must be examined in the context of industry, size, financial condition, its historic pay-for-performance practices, and any other mitigating internal or external factors.

We believe that each company should design and apply specific compensation policies and practices that are appropriate to the circumstances of the company and, in particular, will attract and retain competent executives and other staff, while motivating them to grow the company’s long-term shareholder value. Where we find those specific policies and practices serve to reasonably align compensation with performance, and such practices are adequately disclosed, Glass Lewis will recommend supporting the company’s approach. If, however, those specific policies and practices fail to demonstrably link compensation with performance, Glass Lewis will generally recommend voting against the say-on-pay proposal.

Glass Lewis reviews say-on-pay proposals on both a qualitative basis and a quantitative basis, with a focus on four main areas:

- The overall design and structure of the company’s executive compensation program.
- The quality and content of the company’s disclosure.
- The quantum paid to executives.
- The link between compensation and performance as indicated by the company’s pay-for-performance practices.

Any significant changes or modifications made to the company’s compensation structure or award amounts, including base salaries, are also taken into consideration.

In cases where our analysis reveals a compensation structure in drastic need of reform, we may recommend that shareholders vote against the say-on-pay proposal. Generally such instances include evidence of a pattern of poor pay-for-performance practices, unclear or questionable disclosure regarding the overall compensation structure (i.e., limited information regarding benchmarking processes, limited rationale for bonus performance metrics and targets, etc.), questionable adjustments to certain aspects of the overall compensation structure (i.e., limited rationale for significant changes to performance targets or metrics, the payout of guaranteed bonuses or sizable retention grants, etc.), and/or other egregious compensation practices.

Although not an exhaustive list, we believe the following practices are indications of problematic pay practices which may cause Glass Lewis to recommend against a say on pay vote:

- Inappropriate peer group and/or benchmarking issues.
- Inadequate discussion of the company’s approach to risk management, including the absence of features such as clawback mechanisms, anti-hedging policies, or executive share ownership guidelines.
- No disclosed target or maximum limits on variable compensation. When present, such limits could be set in reference to base salary.
- Egregious or excessive bonuses, equity awards or severance payments, including golden handshakes and golden parachutes. Employment contracts should typically limit severance payments to no more than two years.
- Performance targets which are not sufficiently challenging, and/or provide for high potential payouts.
- Performance targets lowered without justification.
- Problematic contractual payments, such as guaranteed bonuses.
- Highly discretionary or otherwise underdeveloped compensation plans, including plans that rely heavily on a subjective assessment of performance.
- Executive pay that is comparably high (as compared to the company’s peers), and is not reinforced by outstanding company performance.
- The terms of the long-term incentive plans are inappropriate (please see “Long-Term Incentives”).

In instances where a company has failed to provide sufficient disclosure of its policies, we may recommend shareholders vote against this proposal solely on this basis, regardless of the appropriateness of compensation levels.

In the case of companies that maintain poor compensation policies year after year without any apparent steps to address the issues, we may also recommend that shareholders vote against the chair and/or additional members of the compensation committee. We may also recommend voting against the committee based on the practices or actions of its members, such as approving large one-off payments, the inappropriate use of discretion, or sustained poor pay for performance practices.

## **ELEMENTS OF INCENTIVE-BASED COMPENSATION**

### **SHORT-TERM INCENTIVES**

A short-term bonus or incentive (“STI”) should be demonstrably tied to performance. Whenever possible, we believe a mix of corporate and individual performance measures is appropriate. We would normally expect performance measures for STIs to be based on company-wide or divisional financial measures as well as non-financial factors such as those related to employee turnover, safety, environmental issues, and customer satisfaction. While we recognize that companies operating in different sectors or markets may seek to utilize a wide range of metrics, we expect such measures to be appropriately tied to a company’s business drivers.

Further, Glass Lewis recognizes that some measures may involve the disclosure of commercially confidential information but we believe companies should justify such non-disclosure.<sup>37</sup> However, where a short-term bonus has been paid, companies should disclose the extent to which performance has been achieved against relevant targets, including disclosure of the actual target achieved.

Where management has received significant STIs but short-term performance over the previous year appears, prima facie, to be poor or negative, the company should provide a clear explanation of why these significant short-term payments were made.

The target and potential maximum awards that can be achieved under STI awards should be disclosed. Shareholders should expect stretching performance targets for the maximum award to be achieved. Any increase in the potential target and maximum award should be clearly justified to shareholders.

## LONG-TERM INCENTIVES

Glass Lewis recognizes the value of equity-based incentive programs. When used appropriately, they can provide a vehicle for linking executive pay to company performance, thereby aligning their interests with those of shareholders. In addition, equity-based compensation can be an effective way to attract, retain and motivate key employees.

We feel that executives should be compensated with equity when their performance and that of the company warrants such rewards. While we do not believe that equity-based compensation plans for all employees need to be based on overall company performance, we do support such performance limitations for grants to senior executives (although even some equity-based compensation of senior executives without performance criteria is acceptable, such as in the case of moderate incentive grants included in an initial offer of employment).

Boards often argue that linking equity-based pay to performance would hinder them in attracting talent. We believe that boards can develop a consistent, reliable approach that would still attract executives who believe in their ability to guide the company to achieve its targets. If the board believes in performance-based compensation for executives, then these provisions typically will not hamper the board's ability to create such compensation plans. We generally prefer that at least a portion of medium or long-term incentives be linked to specific performance targets, particularly for developed companies.

## STOCK OPTIONS

Stock options remain the most common form of long-term incentive in Canada. While option plans rarely include performance goals, options are generally granted at market price (or at a discount of up to 25%, for venture issuers, as permitted by the TSX Venture Exchange).

Many Canadian companies operate "rolling" option plans, whereby a company is authorized to issue a fixed percentage of its issued share capital (typically 10%) as compensatory shares. Venture firms utilizing rolling maximum plans must resubmit them for shareholder approval on an annual basis, while firms on the main market are required to resubmit such plans for approval every three years.

Such frequent requisite approval affords shareholders the opportunity to closely monitor equity compensation practices and express their approval, or lack thereof, on a regular basis. This practice increases management's accountability to shareholders for the company's remuneration practices, which should inhibit irresponsible behavior and limit unduly generous compensation arrangements.

We use a number of different analyses to evaluate stock option plans, comparing the program with both a carefully chosen peer group and reasonable absolute limits that we believe (and academic studies have shown) are key to equity value creation. In general, our model seeks to determine whether the proposed plan is either: (i) more than one standard deviation away from the average plan for the peer group on a range of criteria, such as projected annual cost compared to operating income, net income, revenue, enterprise value, etc.; or

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<sup>37</sup> National Instrument 51-102F6, Item 2.1 (4).

(ii) exceeds one of the absolute limits we have put in place to safeguard against creeping averages. Each analysis is weighted and plans are scored in accordance with that weight.

Our recommendations regarding stock option plans are guided by our stock option plan analysis model. When a proposal seeks shareholder approval for a new plan or changes to any quantitative element of an existing stock option plan, we will evaluate the plan using our stock option model.

If the proposal contains only non-quantitative amendments to an existing stock option plan, e.g., is not seeking additional shares, we will assess the proposed amendments against general principles of equity-based compensation plans and current best practice.

We evaluate option plans based on the following overarching principles:

- Companies should seek more shares only when needed.
- In the case of rolling equity plans, generally, the maximum percentage of shares available for issuance should not exceed 10%.
- Fixed plans should be small enough that companies should seek approval every three to four years.
- Annual net share count and voting power dilution should be limited.
- The annual cost of the plan (especially if not shown on the income statement) should be reasonable as a percentage of financial results and in line with the peer group(s).
- The expected annual cost of the plan should be proportional to the value of the business.
- The intrinsic value received by option grantees in the past should be reasonable compared with the financial results of the business.
- The plan should deliver value on a per-employee basis when compared with programs at peer companies.
- Plans should not permit the repricing of stock options without shareholder approval.
- Plans should not contain excessively liberal administrative or payment terms.
- Plans should be administered by independent directors.
- Plans should not contain provisions allowing for excessive payouts in the event of a change of control.

Options are a very important component of compensation packages that are used to attract and retain experienced executives and other key employees. Tying a portion of an executive's compensation to the performance of the company also provides an effective incentive to maximize shareholder value by those in the best position to affect those values. However, we believe that such plans should include reasonable limits so as not to provide out-sized award levels or excessively dilute existing shareholders.

## FULL VALUE AWARDS

The use of "full-value" awards, often tied to performance criteria or vesting schedules, is becoming more common in Canada. These awards are often granted in conjunction with stock options, and may be referred to as "medium-term" or "long-term" incentives. Some of the common full-value plans seen in Canada are "Restricted Share Plans", "Deferred Share Plans", "Share Award Plans" and "Incentive Compensation Plans."

Because the value ultimately received by executives typically depends on achievement of specific performance goals rather than share price gains, we generally consider such awards to provide better alignment with shareholder interests than stock options. However, because executives receive the full value of vested awards at no cost, an appropriate structure, including challenging performance targets and vesting schedules, is necessary to ensure that such awards accurately reflect performance. Glass Lewis believes that companies should strive for full-value award plans with the following features:

- The inclusion of performance metrics.
- Performance periods of at least three years.
- At least one relative performance metric that compares the company's performance to a relevant peer group or index.
- No re-testing or lowering of performance conditions.
- Performance metrics that cannot be easily manipulated by management.
- Stretching metrics that incentivize executives to strive for outstanding performance.
- Individual limits expressed as a percentage of base salary.
- Reasonable plan limits as a percentage of the company's issued share capital.

Performance measures should be carefully selected and should relate to the specific business/industry in which the company operates and, especially, the key value drivers of the company's business.

While cognisant of the inherent complexity of certain performance metrics, as discussed above Glass Lewis generally believes that measuring a company's performance with multiple metrics serves to provide a more complete picture of the company's performance than a single metric, which may focus too much management attention on a single target. When utilized for relative measurements, external benchmarks such as a sector index or peer group should be disclosed and transparent. The rationale behind the selection of a specific index or peer group should be disclosed. Internal benchmarks should also be disclosed and transparent, unless a cogent case for confidentiality is made and fully explained.

Some of the provisions of full-value award plans that could contribute to an "against" recommendation from Glass Lewis include the following:

- A plan limit set at a rolling maximum of more than 5% of a company's share capital.
- The absence of any performance conditions or vesting provisions.
- Failure to disclose a clear description of performance hurdles and vesting schedules.
- Participation of non-executive directors on the same basis as company executives.
- Administration of the plan by non-independent members of the board.
- The inclusion of a single-trigger change of control provision.

Some companies have sought to adopt full-value award plans that employ the same 10% rolling maximum limit commonly prescribed for Canadian stock option plans (see "Stock Options" section). However, given the substantially greater cost of full-value award grants, we consider rolling limits above 5% to be excessive.

Finally, Glass Lewis will also take into consideration the company's historic equity granting practices and overall executive compensation structure. Companies with a history of excessive equity-granting practices or poorly structured, or disclosed, executive compensation practices are more likely to have similar issues with their full-value award plans, which will be taken into consideration when determining our voting recommendation for the renewal or adoption of such a plan.

## TRANSITIONAL AND ONE-OFF AWARDS

Glass Lewis believes shareholders should generally be wary of awards granted outside of the standard incentive schemes outlined above, as such awards have the potential to undermine the integrity of a company's regular incentive plans, the link between pay and performance or both. We generally believe that if the existing incentive programs fail to provide adequate incentives to executives, companies should redesign their compensation programs rather than make additional grants.

However, we recognize that in certain circumstances, additional incentives may be appropriate. In these cases, companies should provide a thorough description of the awards, including a cogent and convincing explanation of their necessity and why existing awards do not provide sufficient motivation. Further, such awards should be tied to future service and performance whenever possible.

Similarly, we acknowledge that there may be certain costs associated with transitions at the executive level. We believe that sign-on arrangements should be clearly disclosed and accompanied by a meaningful explanation of the payments and the process by which the amounts are reached. Furthermore, the details of and basis for any "make-whole" payments (which are paid as compensation for forfeited awards from a previous employer) should be provided.

While in limited circumstances such deviations may not be inappropriate, we believe shareholders should be provided with a meaningful explanation of any additional benefits agreed upon outside of the regular arrangements. Furthermore, for severance or sign-on arrangements, we may also consider the executive's regular target compensation levels or the sums paid to other executives (including the recipient's predecessor, where applicable) in evaluating the appropriateness of such an arrangement.

Additionally, we believe companies making supplemental or one-time awards should also describe if and how the regular compensation arrangements will be affected by these additional grants. In reviewing a company's use of supplemental awards, Glass Lewis will evaluate the terms and size of the grants in the context of the company's overall incentive strategy and granting practices, as well as the current operating environment.

## OPTION REPRICING

Glass Lewis views option repricing plans and option exchange programs with great skepticism. Shareholders have substantial, real downside risk in owning stock and we believe that the employees, officers and directors who receive stock options should be similarly situated to align interests optimally. We are concerned that option grantees who believe they will be "rescued" from underwater options will be more inclined to take on unjustifiable risks in the future. Moreover, a predictable pattern of repricing or exchanges can substantially alter the value of a stock option; options that will practically never expire deeply out of the money are worth far more than options that carry such a risk. In short, repricings and option exchange programs change the bargain between shareholders and employees after the bargain has been struck. Repricing is tantamount to a re-trade.

In general, we evaluate option repricing proposals on a case-by-case basis. While we are generally inclined to recommend voting against any proposal to reprice options, there are circumstances in which an option repricing may be appropriate, provided that the following criteria are true:

1. The stock decline mirrors the market or industry price decline in terms of timing and magnitude.

2. The new exercise price and terms of the options are reasonable, and management has provided a thorough explanation as to how such terms were decided.
3. Management and the board make a cogent case for needing to incentivize and retain existing employees.

## **TSX RULES ON PLAN AMENDMENTS**

TSX rules currently require that, in order for a company to amend an equity-based pay plan, that plan must specify whether shareholder approval is required for the relevant type of amendment. Companies had until June 30, 2007, to adopt the proper amendment procedures. Since this date, companies that have general amendment procedures are no longer able to make any amendments without shareholder approval, including amendments considered to be of a “housekeeping” nature.

TSX rules also provide that shareholder approval is required for an extension of the terms or repricing of options held by insiders. As a result, we have seen, and will most likely continue to see, proposals seeking to automatically extend the expiry date of an option in the event that the option expires during or shortly after a blackout period. We do not believe such proposals are of concern to shareholders, provided that the proposed expiration provisions have been adequately disclosed to shareholders, and that the terms are such that: (i) the extension is only available when the blackout period is self-imposed by the company (i.e., not where the company or insiders are subject to a cease trade order); (ii) the extension is for a reasonable and fixed period of time (i.e., five to ten business days) that is not subject to board discretion; and (iii) the extension is available to all eligible participants under the plan, under the same terms and conditions.

## **LIMITS ON EXECUTIVE COMPENSATION**

Generally, Glass Lewis believes shareholders should not be directly involved in setting executive pay. Such matters should be left to the compensation committee. In the absence of an advisory “Say-on-Pay” vote, we view the election of compensation committee members as an appropriate mechanism for shareholders to express their disapproval or support of board policy on executive pay. Further, we believe that companies whose pay-for-performance is in line with their peers should be able to pay their executives in a way that drives growth and profit, without destroying ethical values, giving consideration to their peers’ comparable size and performance.

## **COMPANY RESPONSIVENESS**

At companies that received a significant level of shareholder opposition (20% or greater) to their say-on-pay proposal at the previous annual meeting, we believe the board should demonstrate some level of engagement and responsiveness to the shareholder concerns behind the discontent, particularly in response to shareholder engagement. While we recognize that sweeping changes cannot be made to a compensation program without due consideration and that a majority of shareholders voted in favor of the proposal, we believe the compensation committee should provide some level of response to a significant vote against, including engaging with large shareholders to identify their concerns. In the absence of any evidence that the board is actively engaging shareholders on these issues and responding accordingly, we may recommend holding compensation committee members accountable for failing to adequately respond to shareholder opposition, giving careful consideration to the level of shareholder protest and the severity and history of compensation problems.

## **PAY FOR PERFORMANCE**

Glass Lewis believes an integral part of a well-structured compensation package is a successful link between pay and performance. Therefore, Glass Lewis developed a proprietary pay-for-performance model to evaluate the link between pay and performance of the top five executives at Canadian companies. Our model benchmarks these executives’ pay and company performance against peers selected by Equilar’s market-based peer groups and across five performance metrics. By measuring the magnitude of the gap between two weighted-average percentile rankings (executive compensation and performance), we rank companies based on a

grade system. The grades guide our evaluation of compensation committee effectiveness, and we generally recommend voting against compensation committee members at companies with a pattern of failing our pay-for-performance analysis. Unlike a school letter system, however, the letter “C” in the Glass Lewis grade system does not indicate a significant lapse; rather, a “C” in the Glass Lewis grade system identifies companies where the pay and performance percentile rankings relative to peers are generally aligned. This suggests that the company neither overpays nor underpays its executives relative to its comparator group.

The grades “A” and “B” are also designated to companies which align pay with performance. However, these grades indicate lower compensation levels relative to the market and to company performance. A “B” grade stems from slightly higher performance levels in comparison to market peers while executives earn relatively less than peers. Receiving an “A” in our analysis shows that the company is paying significantly less than peers while outperforming the comparator group.

A grade of “D” or “F” in our analysis is due to high pay and low performance relative to the comparator group. In our analysis, we differentiate between a disconnect between pay and performance, “D”, and a significant disconnect, “F”. An “F” grade in our analysis indicates that executives receive significantly higher compensation than peers while underperforming the market.

We also use this analysis to inform our voting decisions on say-on-pay proposals. As such, if a company receives a failing grade from our proprietary model, we are more likely to recommend shareholders to vote against the say-on-pay proposal. However, other qualitative factors such as an effective overall incentive structure, significant forthcoming enhancements or reasonable long-term payout levels may give us cause to recommend in favor of a proposal even when we have identified a disconnect between pay and performance.

## **CLAWBACK PROVISION**

We believe emerging best practice has come to promote the use of clawback, or ‘malus’ provisions to safeguard against unwarranted short- and long-term awards and to similarly encourage executives and senior management to take a more comprehensive view of risk when making business decisions. Such provisions generally allow for some or all of an award to be recouped in the case of a material misstatement or misconduct.

## **DIRECTOR COMPENSATION**

Glass Lewis believes that non-employee directors should receive reasonable and appropriate compensation for the time and effort they spend serving on the board and its committees. In particular, we recognize that well-designed compensation plans that include option grants or other equity-based awards can help to align the interests of outside directors with those of shareholders. However, such grants for non-employee directors should not be tied to performance conditions, as a focus on specific aspects of financial performance could hinder a director’s independence. Rather, we prefer a compensation structure that provides directors with the option of receiving some or all of their fees in deferred share units or common shares that are restricted until the director leaves the board. In our opinion, even share options without performance conditions run the risk of focusing the attention of directors on the short-term performance of the company’s share price.

Director fees should be reasonable in order to retain and attract qualified individuals. At the same time, excessive fees represent a financial cost to the company and threaten to compromise the objectivity and independence of non-employee directors. We compare the costs of these plans to the plans of peer companies with similar market capitalizations in the same country to help inform our judgment on this issue.

# Governance Structure and the Shareholder Franchise

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## AMENDMENTS TO THE ARTICLES OF ASSOCIATION

We will evaluate proposed amendments to a company's articles of association on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from evaluating each amendment on its own merits. In such cases, we will analyze each change individually and recommend voting for the proposal only when we believe that, on balance, all of the amendments are in the best interests of shareholders.

## QUORUM REQUIREMENTS

Glass Lewis believes that a company's quorum requirement should be set at a level high enough to ensure that a broad range of shareholders are represented in person or by proxy, but low enough that the company can transact necessary business. Pursuant to section 139 of the CBCA, irrespective of the number of persons present at a meeting, a majority of shares entitled to vote, either in person or by proxy, shall constitute a quorum. However, companies are permitted to stipulate a lower quorum requirement in the articles of association with the approval of shareholders. As such, should a company seek shareholder approval of a lower quorum requirement, we will generally permit a reduced quorum of at least 33% of shares entitled to vote, either in person or by proxy, when evaluating such proposals in consideration of the specific facts and circumstances of the company such as size and shareholder base.

However, when companies adopting new articles set quorum at 25% or higher, we will support the adoption so long as the new quorum represents an increase, or remains unchanged from prior levels.

Additionally, with regard to the number of directors required to constitute an acceptable quorum for a meeting of directors, Glass Lewis looks for a requisite quorum of a majority of the directors of the board.

## ADVANCE NOTICE POLICIES

Glass Lewis recognizes the significant risks to shareholders from so-called "stealth proxy contests" whereby a shareholder nominates a director for election at a company's annual meeting without prior notice to the company or other shareholders. This could result in the election of a shareholder-nominated director with little to no support from other shareholders, in some cases exacerbated by low quorum requirements. It is reasonable, therefore, for companies to seek means, such as advance notice provisions, to ensure they (and shareholders) receive adequate notice in advance shareholder meetings of the intention of a shareholder to nominate one or more directors at the meeting.

However, we believe such provisions should be limited in scope to balance providing timely notice of the nomination to the company and shareholders against inhibiting the exercise of the nomination right. Glass Lewis therefore believes restrictions imposed under advance notice provisions should be reasonable so as not to present excessive impediments on shareholders who wish to nominate directors under such a policy. Accordingly, Glass Lewis will review such policies in consideration of the required time frames for shareholders to submit director nominations as well as other provisions setting forth requirements shareholders must meet to nominate directors.

Specifically, we will generally recommend that shareholders support policies that establish a reasonable notification period (generally 30 days) prior to the date of the annual meeting for shareholders to nominate one or more directors and that require a reasonably broad time period (e.g., a 35-day window) during which shareholders may submit such nominations.

Glass Lewis may consider recommending that shareholders vote against advance notice provisions if the minimum notice period is either too close to (e.g., 10 days) or too far in advance of (e.g., 60 days) the annual meeting. In addition, we will generally recommend that shareholders oppose such provisions where an advance notice policy does not allow for the commencement of a new time period for shareholder nominations in the event of an adjournment or postponement of the annual meeting.

Further, we will review advance notice policies to determine whether an issuer has implemented any unnecessarily burdensome or onerous requirements on shareholders seeking to nominate directors. In particular, Glass Lewis will review impediments to the nominations process such as excessive disclosure requirements (e.g., of sensitive, personal or irrelevant information), required commitments or undertakings to abide by unnecessarily broad or restrictive agreements, requirements to meet with certain individuals such as incumbent board members or other impediments that may frustrate shareholders ability or willingness to avail themselves of the nomination process.

## **VIRTUAL SHAREHOLDER MEETINGS**

A relatively small but growing contingent of companies have elected to hold shareholder meetings by virtual means only. Glass Lewis believes that virtual meeting technology can be a useful complement to a traditional, in-person shareholder meeting by expanding participation of shareholders who are unable to attend a shareholder meeting in person (i.e. a “hybrid meeting”). However, we also believe that virtual-only meetings have the potential to curb the ability of a company’s shareholders to meaningfully communicate with the company’s management.

Prominent shareholder rights advocates, including the Council of Institutional Investors, have expressed concerns that such virtual-only meetings do not approximate an in-person experience and may serve to reduce the board’s accountability to shareholders. When analyzing the governance profile of companies that choose to hold virtual-only meetings, we look for robust disclosure in a company’s proxy statement which assures shareholders that they will be afforded the same rights and opportunities to participate as they would at an in-person meeting.

In 2018, we will not make voting recommendations solely on the basis that a company is holding a virtual-only meeting. Beginning in 2019, however, Glass Lewis will generally recommend voting against members of the governance committee of a board where the board is planning to hold a virtual-only shareholder meeting and the company does not provide such disclosure.

## **ANTI-TAKEOVER MEASURES**

### **POISON PILLS (SHAREHOLDER RIGHTS PLANS)**

Glass Lewis believes that poison pill plans generally are not in the best interests of shareholders. Specifically, they can reduce management accountability by substantially limiting opportunities for corporate takeovers. Rights plans can thus prevent shareholders from receiving a buy-out premium for their stock.

We believe that boards should be given wide latitude in directing the activities of the company and charting the company’s course. However, where the link between the financial interests of shareholders and their right to consider and accept buyout offers is so substantial, we believe that shareholders should be allowed to vote on whether or not they support such a plan’s implementation. This issue is different from other matters that are typically left to the board’s discretion since its potential impact on and relation to shareholders is direct and substantial. It is also an issue in which the interests of management may be very different from those of shareholders, and therefore ensuring shareholders have a voice is the only way to safeguard their interests.

Subject to the inclusion of certain standard provisions, we will generally support a limited poison pill to accomplish a particular objective, such as the closing of an important merger, or a pill that contains what we believe to be a reasonable “qualifying offer” clause. We will consider supporting a poison pill plan if the trigger threshold is not unreasonably low (i.e., lower than 20%) and the provisions of the qualifying offer clause include the following attributes: (i) the form of offer is not required to be an all-cash transaction; (ii) the offer is not required to remain open for more than 105 business days; (iii) the offeror is permitted to make amendments to the offer, to reduce the offer or otherwise change the terms; (iv) there is no fairness opinion requirement; (v) there is a low to no premium requirement; and (vi) the plan does not allow the board the discretion to amend material provisions without shareholder approval.

Additionally, Glass Lewis will review the definition of beneficial ownership in such plans to ensure that ownership is strictly defined as shares held by an individual and does not include shares that are not owned, but can be directed to vote by a shareholder; Glass Lewis will generally oppose the adoption of such pills, also known as “voting pills,” that expand the circumstances when a pill would be triggered including in the absence of a bid for the company. When these requirements are met, we typically feel comfortable that shareholders will have the opportunity to voice their opinion on any legitimate offer. Further, it should be noted that poison pills must be approved by shareholders every three years.

## EXCLUSIVE FORUM PROVISIONS

Glass Lewis recognizes that companies may be subject to frivolous and opportunistic lawsuits, particularly in conjunction with a merger or acquisition, that are expensive and distracting. In response, companies may find ways to prevent or limit the risk of such suits by adopting bylaws regarding where the suits must be brought or shifting the burden of the legal expenses to the plaintiff, if unsuccessful at trial.

Glass Lewis believes that charter or bylaw provisions limiting a shareholder’s choice of legal venue are not in the best interests of shareholders. Such clauses may effectively discourage the use of shareholder claims by increasing their associated costs and making them more difficult to pursue. As such, shareholders should be wary about approving any limitation on their legal recourse including limiting themselves to a single jurisdiction without compelling evidence that it will benefit shareholders.

For this reason, we recommend that shareholders vote against any bylaw or charter amendment seeking to adopt an exclusive forum provision unless the company: (i) provides a compelling argument on why the provision would directly benefit shareholders; (ii) provides evidence of abuse of legal process in other, non-favored jurisdictions; (iii) narrowly tailors such provision to the risks involved; and (iv) maintains a strong record of good corporate governance practices.

Moreover, in the event a board seeks shareholder approval of a forum selection clause pursuant to a bundled bylaw amendment rather than as a separate proposal, we will weigh the importance of the other bundled provisions when determining the vote recommendation on the proposal.

## INCREASE IN AUTHORIZED SHARES

Glass Lewis believes that adequate share capital is important to the operation of a company. Companies generally seek an increase in authorized share capital in order to conduct equity fundraisings, stock splits or declare share dividends. We believe that it is critical for management to have access to a sufficient amount of the share capital in order to allow for quick decision-making and effective operations. However, prior to any significant transaction, we prefer that management justifies its use of any additional shares to shareholders, rather than simply asking for a blank check in the form of large pools of unallocated shares that can be used for any purpose.

In general, we will support proposals to increase authorized shares by up to 100% of the number of shares currently authorized; however, if the proposed increase would result in less than 30% of all authorized shares being outstanding, then we may recommend shareholders reject the proposal.<sup>38</sup>

<sup>38</sup> Pursuant to the CBCA, companies may only increase their share capital subsequent to shareholder approval of a special resolution.

## ISSUANCE OF SHARES

We recognize the viable reasons companies may have to issue shares; however, we also recognize that issuing shares dilutes existing holders in most circumstances. Further, the availability of additional shares, where the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, when we find that a company has not detailed a plan for the use of the proposed shares, or when the number of shares is excessive, we typically recommend shareholders vote against the issuance.

In the case of a private placement, we will also consider whether the company is offering the securities at a discount to its share price.<sup>39</sup>

In November 2009, the TSX updated its requirements to provide that shareholder approval be required when a company intends to issue shares in excess of 25% of issued share capital as payment for an acquisition.

In general, we will support proposals to issue shares with preemptive rights of up to 100% of the number of shares currently issued, and proposals to issue shares without preemptive rights of up to 20% of the current issued share capital. However, note that there are no preemptive rights in Canada unless specifically called for in a company's articles of association.

## VOTING STRUCTURE

### DUAL-CLASS SHARE STRUCTURES

Glass Lewis believes dual-class voting structures are typically not in the best interests of common shareholders. Allowing one vote per share generally operates as a safeguard for common shareholders by ensuring that those who hold a significant minority of shares are able to weigh in on issues set forth by the board.

Furthermore, we believe that the economic stake of each shareholder should match their voting power and that no small group of shareholders, family or otherwise, should have voting rights different from those of other shareholders. On matters of governance and shareholder rights, we believe shareholders should have the power to speak and the opportunity to effect change. That power should not be concentrated in the hands of a few for reasons other than economic stake.

We generally consider a dual-class share structure to reflect negatively on a company's overall corporate governance. Because we believe that companies should have share capital structures that protect the interests of non-controlling shareholders as well as any controlling entity, we typically recommend that shareholders vote in favor of recapitalization proposals to eliminate dual-class share structures. Similarly, we will generally recommend against proposals to adopt a new class of common stock.

With regards to our evaluation of corporate governance following an IPO or spin-off within the past year, we will now include the presence of dual-class share structures as an additional factor in determining whether shareholder rights are being severely restricted indefinitely.

When analyzing voting results from meetings of shareholders at companies controlled through dual-class structures, we will carefully examine the level of approval or disapproval attributed to unaffiliated shareholders when determining whether board responsiveness is warranted. Where vote results indicate that a majority of unaffiliated shareholders supported a shareholder proposal or opposed a management proposal, we believe the board should demonstrate an appropriate level of responsiveness.

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<sup>39</sup> Pursuant to the TSX Listing Rules, shareholder approval is required for issuances of stock by private placement of more than 25% of the number of shares outstanding in any six month period. However, issuances below this threshold are at the discretion of the board, which may issue any number of shares and determine their rights, privileges and restrictions.

## SUPERMAJORITY VOTE REQUIREMENTS

Glass Lewis believes that supermajority vote requirements impede shareholder action on ballot items critical to shareholder interests. An example is in the takeover context, where supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business. This in turn degrades share value and can limit the possibility of buyout premiums to shareholders. Moreover, we believe that a supermajority vote requirement can enable a small group of shareholders to overrule the will of the majority of shareholders. We believe that a simple majority is appropriate to approve all matters presented to shareholders.

## CUMULATIVE VOTING

Cumulative voting increases the ability of minority shareholders to elect a director by allowing shareholders to cast as many shares of the stock they own multiplied by the number of directors to be elected. As companies generally have multiple nominees up for election, cumulative voting allows shareholders to cast all of their votes for a single nominee, or a smaller number of nominees than up for election, thereby raising the likelihood of electing one or more of their preferred nominees to the board. It can be important when a board is controlled by insiders or affiliates and where the company's ownership structure includes one or more shareholders who control a majority-voting block of company stock.

Glass Lewis believes that cumulative voting generally acts as a safeguard for shareholders by ensuring that those who hold a significant minority of shares can elect a candidate of their choosing to the board. This allows the creation of boards that are responsive to the interests of all shareholders rather than just a small group of large holders.

We review cumulative voting proposals on a case-by-case basis, factoring in the independence of the board and the status of the company's governance structure. But we typically find these proposals on ballots at companies where independence is lacking and where the appropriate checks and balances favoring shareholders are not in place. In those instances we typically recommend in favor of cumulative voting.

Where a company has adopted a true majority vote standard (i.e., where a director must receive a majority of votes cast to be elected, as opposed to a modified policy indicated by a resignation policy only), Glass Lewis will recommend voting against cumulative voting proposals due to the incompatibility of the two election methods. For companies that have not adopted a true majority voting standard but have adopted some form of majority voting, Glass Lewis will also generally recommend voting against cumulative voting proposals if the company has not adopted anti-takeover protections and has been responsive to shareholders.

Where a company has not adopted a majority voting standard and is facing both a shareholder proposal to adopt majority voting and a shareholder proposal to adopt cumulative voting, Glass Lewis will support only the majority voting proposal. When a company has both majority voting and cumulative voting in place, there is a higher likelihood of one or more directors not being elected as a result of not receiving a majority vote. This is because shareholders exercising the right to cumulate their votes could unintentionally cause the failed election of one or more directors for whom shareholders do not cumulate votes.

## MAJORITY VOTING

Over the past several decades, shareholders have sought a mechanism by which they might have a genuine voice in the election of directors. The common plurality vote standard ensures that directors who receive the highest number of votes are elected to serve on the board of directors. This system, at face value, appears to be a fair conduit through which the most favored candidates will be selected for service on the board. This system loses its efficacy, however, when the number of director candidates is equal to the number of open seats on the board, thereby permitting a nominee who receives a minority of shareholder support (as little as one vote) to assume a seat on the board. Majority voting, to the contrary, requires that each nominee receive the affirmative vote of at least a majority of shareholder votes cast in an election. In this manner a majority vote

standard enhances shareholders' ability to determine who will serve as their representatives in the boardroom, resulting in increased board accountability and performance.

The TSX Company Manual now requires all TSX-listed issuers (with an exception for controlled companies) to adopt majority voting for the election of directors effective June 30, 2014.

Almost all companies that have adopted majority voting policies have opted for a director resignation policy in which any director who has received a majority of the total votes "withheld" from him or her (in an uncontested election) promptly tenders their resignation to the board or its nominating/corporate governance committee for consideration. The board or committee then considers the resignation and makes a decision on whether to accept or reject it. Such policies typically provide for 90 days to consider the resignation, after which the board will make its final decision known by way of a press release.

Although these policies are certainly preferable to no policy at all, since they require the board to consider the outcome of the vote and address shareholders' concerns, we believe there should be no need for further action by the board or any of its committees to have the candidate removed from the board. The board should not have the opportunity to ignore shareholders' will and allow the nominee to continue to serve as a director. The system ultimately leaves the decision-making process in the hands of board members, and not with shareholders, where we believe the power should lie.

## **TRANSACTION OF OTHER BUSINESS**

We typically recommend that shareholders not give their proxy to management to vote on any other business items that may properly come before the annual meeting. In our opinion, granting unfettered discretion is unwise.

# Compensation, Social and Governance Shareholder Initiatives Overview

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Glass Lewis generally believes decisions regarding day-to-day management and policy decisions, including those related to social, environmental or political issues, are best left to management and the board as they in almost all cases have more and better information about company strategy and risk. However, when there is a clear link between the subject of a shareholder proposal and value enhancement or risk mitigation, Glass Lewis will recommend in favor of a reasonable, well-crafted shareholder proposal where the company has failed to or inadequately addressed the issue.

We believe that shareholders should not attempt to micromanage a company, its businesses or its executives through the shareholder initiative process. Rather, we believe shareholders should use their influence to push for governance structures that protect shareholders and promote director accountability. Shareholders should then put in place a board they can trust to make informed decisions that are in the best interests of the business and its owners, and hold directors accountable for management and policy decisions through board elections. However, we recognize that support of appropriately crafted shareholder initiatives may at times serve to promote or protect shareholder value.

To this end, Glass Lewis evaluates shareholder proposals on a case-by-case basis. We generally recommend supporting shareholder proposals calling for the elimination of, as well as to require shareholder approval of, antitakeover devices such as poison pills and classified boards. We generally recommend supporting proposals likely to increase and/or protect shareholder value and also those that promote the furtherance of shareholder rights. In addition, we also generally recommend supporting proposals that promote director accountability and those that seek to improve compensation practices, especially those promoting a closer link between compensation and performance, as well as those that promote more and better disclosure of relevant risk factors where such disclosure is lacking or inadequate.

For a detailed review of our policies concerning compensation, environmental, social and governance shareholder initiatives, please refer to our comprehensive *Proxy Paper Guidelines for Shareholder Initiatives*, available at [www.glasslewis.com](http://www.glasslewis.com).

## DISCLAIMER

This document is intended to provide an overview of Glass Lewis' proxy voting policies and guidelines. It is not intended to be exhaustive and does not address all potential voting issues. Additionally, none of the information contained herein should be relied upon as investment advice. The content of this document has been developed based on Glass Lewis' experience with proxy voting and corporate governance issues, engagement with clients and issuers and review of relevant studies and surveys, and has not been tailored to any specific person.

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