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ARTICLE

2020 Proxy Season: Glass Lewis and ISS Updates

Both Glass, Lewis & Co (Glass Lewis) and Institutional Shareholders Services (ISS) recently released voting guidelines for the 2020 proxy season. The Glass Lewis guidelines are effective for meetings on or after January 1, 2020, and the ISS guidelines are effective for meetings on or after February 1, 2020. This bulletin summarizes the more significant changes to each firm's Canadian guidelines for the 2020 proxy season.

Glass Lewis 2020 Updates

1. Director Attendance and Committee Meeting Disclosure

Glass Lewis will generally recommend a vote Against an issuer's governance committee chair when:

i. beginning in 2020, the issuer does not disclose the meeting attendance records for board and committee meetings; and

ii. beginning in 2021, the issuer does not disclose the number of audit committee meetings that took place during the year.

These triggers are in addition to the existing requirement that directors attend at least 75 per cent of meetings unless they have a valid reason. Moreover, beginning in 2021, Glass Lewis will recommend a vote Against an issuer's audit committee chair if the audit committee did not meet at least four times that year.

2. Electing the Board of Directors

Board Diversity

As of January 1, 2020, issuers incorporated under the *Canada Business Corporations Act* (CBCA) with publicly traded securities are obligated to disclose the number and percentage of women, Aboriginal persons, and members of visible minorities and persons with disabilities on the board of directors and within senior management. Glass Lewis has not altered its guidelines based on these amendments. Nonetheless, Glass Lewis has stated its intention to review any new diversity disclosure and, where relevant, reflect the disclosure in its voting recommendation for director nominees of TSX issuers.

Board Skills

In 2019, Glass Lewis codified a board skills matrix that it utilizes in its analysis of director nominees at TSX 60 issuers. The matrix provides a framework to assess a board's skills and competencies. The 2020 guidelines clarify the expectation for TSX 60 issuers to provide meaningful disclosure of a board's skills and competencies. If a board fails to provide meaningful disclosure, Glass Lewis will consider recommending an Against vote for the chair of the nomination committee or the equivalent.

3. Say-on-Pay Analysis

Glass Lewis reviews the compensation awarded to senior executives and considers the alignment of executive compensation and issuer performance, and the disclosure thereof, as a critical aspect of shareholders' interests. In fact, Glass Lewis believes say-on-pay proposals should be submitted to shareholders annually, despite no legal obligation for issuers to do so. In the 2020 update, Glass Lewis emphasizes that the following contractual payments in favour of executives are problematic: excessive severance payments; new or renewed single-trigger change-in-control arrangements; and multi-year guaranteed awards. The 2020 update suggests that issuers should eliminate, rather than renew or revise, these entitlements.

4. Shareholder Engagement

In the 2020 update, Glass Lewis suggests that an issuer should provide an appropriate response if its last say-on-pay proposal received less than 80 per cent shareholder for votes. Generally, an issuer should engage with shareholders, respond to their concerns and disclose details regarding the engagement and remediation process. While the required response depends on the severity of the shareholder protest, inadequate shareholder engagement may result in a negative voting recommendation for members of the compensation committee.

ISS 2020 Updates

1. Ratification of Auditors

ISS recommends voting For the approval of auditors unless non-audit fees paid to the auditor exceed audit, audit-related, and tax compliance fees. Nevertheless, ISS has long had a carve-out for one-time capital restructuring events and, with proper disclosure, an initial public offering, emergence from bankruptcy, or spinoff would also fall under this limited exemption. The 2020 guidelines broaden the language to permit events such as an M&A transaction (including a disposition) or a re-domiciliation to qualify as one-time capital restructuring events. As in past years, the carve-out only applies if there is adequate disclosure regarding the transaction and the associated fees.

2. Electing the Board of Directors

Excessive Non-Audit Fees

If ISS recommends voting Against the ratification of the auditors, it will also recommend a Withhold vote for members of the audit committee. ISS's rationale is that the audit committee is responsible for overseeing the work of the external auditor and approving non-audit services.

Policy Considerations for Majority-Owned Issuers

ISS considers director nominees who are or who represent a controlling shareholder in majority-owned issuers as non-independent. However, ISS has an exception and may still support the nominee under ISS's board and committee independence policies if the issuer meets certain specified conditions. The 2020 guidelines stipulate that the exception cannot apply to:

i. dual class issuers having common shares with unequal voting or unequal board representation rights; or
ii. director nominees that are members of management.

Director Attendance

Like Glass Lewis, ISS generally recommends a Withhold vote for director nominees that do not meet certain attendance thresholds for board and key committee meetings (at least 75 per cent, subject to certain valid exceptions). The 2020 update makes two changes:

i. ISS clarifies that the 75 per cent attendance threshold is determined based on the aggregate of board and key committee meetings, rather than individually; and
ii. ISS will consider nominees on a case-by-case basis if they only served for part of the fiscal year, or if they are a nominee at a recently publically listed issuer or an issuer that recently graduated to the TSX.

Former CEO/CFO on Audit/Compensation Committee

In 2019, ISS recommended a Withhold vote for any director nominee who is a member of the audit or compensation committee of a TSX issuer and served as:

i. the CEO of the issuer in the past five years; or
ii. the CFO of the issuer in the past three years.

The 2020 update extends the Withhold recommendation to a director nominee who served as the CEO of the issuer's affiliate or a company acquired by the issuer within the past five years, or who served as the CFO of such entities within the past three years. The change aligns ISS's guidelines with the importance ISS places on director independence.

Overboarded Directors

ISS generally recommends a withhold vote for director nominees who are non-CEO directors at a TSX issuer and serve on more than five public issuer boards, or who are CEOs of TSX issuers and serve on the boards of more than two public issuers besides their own (the Withhold recommendation only applies to the outside issuers). The 2020 update provides a limited exception to the overboarding policy for director nominees that have committed to stepping down from one or more outside boards and have disclosed this information leading up to the shareholder meeting.

3. Equity Based Compensation for Venture-Listed Issuers

The 2020 update introduces an additional factor for the case-by-case review of TSX-V and CSE-listed issuers' equity compensation plans. If a plan is an 'evergreen plan' (*i.e.*, it is a rolling equity plan that enables auto-replenishment of share reserves without requiring periodic shareholder approval at least every three years), it will generally trigger a vote Against recommendation. Furthermore, for meetings on or after February 1, 2021, ISS will also recommend a Withhold vote if the issuer maintains an evergreen plan, has not sought approval of the plan in the past two years, and does not seek shareholder approval at the meeting. This update is particularly important for CSE-listed issuers because unlike the TSX-V, the CSE does not require annual reconfirmation of rolling equity plans.

4. Incorporation of Economic Value Added (EVA) Metrics

ISS strives to provide investors with information to assess pay and performance alignment. In its 2019 reports, ISS used GAAP-based criteria for its Financial Performance Assessment (FPA). However, ISS recognizes that GAAP-based metrics can distort true economic performance. The EVA metrics represent the economic profit an issuer earns after meeting all its obligations and provide supplemental understanding of an issuer's performance. Starting in 2020, ISS will utilize EVA metrics in its FPA analysis.

Conclusion

The ISS and Glass Lewis updates demonstrate the rapidly changing trends and best practices in corporate governance. Given the impact ISS and Glass Lewis recommendations can have on shareholder voting, issuers are well advised to consider the guidelines and respond as appropriate. As the 2020 proxy season approaches, feel free to contact BLG if you have questions related to the ISS or Glass Lewis updates, or for more information on any other corporate governance initiatives.

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