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Canadian Corporate Governance Policy

2014 Updates

November 21, 2013

Institutional Shareholder Services Inc.

ISS' Canadian Corporate Governance Policy
2014 Updates

Effective for Meetings on or after Feb. 1, 2014
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SUMMARY OF ISS' POLICY FORMULATION PROCESS

Each year, ISS' Global Policy Board conducts a robust, inclusive, and transparent global policy formulation process that produces the benchmark proxy voting guidelines that will be used during the upcoming year.

The policy review and update process begins with an internal review of emerging issues and notable trends across global markets. Based on data gathered throughout the year (particularly from client and issuer feedback), ISS forms policy committees by governance topics and markets. As part of this process, the policy team examines academic literature, other empirical research, and relevant commentary. ISS also conducts surveys, convenes roundtable discussions, and posts draft policies for review and comment. Based on this broad input, ISS' Global Policy Board reviews and approves final drafts and policy updates for the following proxy year. Annual updated policies are announced in November and apply to meetings held on and after February 1 of the following year.

Also, as part of the process, ISS collaborates with clients with customized approaches to proxy voting. ISS helps these clients develop and implement policies based on their organizations' specific mandates and requirements. In addition to the ISS regional benchmark (standard research) policies, ISS' research analysts apply more than 400 specific policies, including specialty policies for Socially Responsible Investors, Taft-Hartley funds and managers, and Public Employee Pension Funds, as well as hundreds of fully customized policies that reflect clients' unique corporate governance philosophies. The vote recommendations issued under these policies often differ from those issued under the ISS benchmark policies. ISS estimates that the majority of shares that are voted by ISS' clients fall under ISS' custom or specialty recommendations.

Key Strengths of ISS' Policy Formulation Process

Industry-Leading Transparency: ISS promotes openness and transparency in the formulation of our proxy voting policies and the application of these policies in all global markets. A description of the policy formulation and application process, including specific guidelines and Frequently Asked Questions, appear on our website under the Policy Gateway section.

Robust Engagement Process with Industry Participants: Listening to diverse viewpoints is critical to an effective policy formulation and application process. ISS' analysts routinely interact with company representatives, institutional investors, shareholder proposal proponents, and other parties to gain deeper insight into critical issues. This ongoing dialogue enriches our analysis and informs our recommendations to clients.

Global Expertise: ISS ' policy formulation process is rooted in global expertise. ISS' network of global offices provides access to regional and local market experts for the Americas, EMEA (Europe/Middle East/Africa), and Asia-Pacific regions.

This document presents the changes being made to ISS' Benchmark Canadian Corporate Governance Policies. The full text of the updates, detailed results from the Policy Survey, and comments received during the open comment period, are all available on ISS' Web site under the Policy Gateway.

The ISS 2014 Canadian Policy Updates will be effective for meetings on or after February 1, 2014. In December 2013, ISS will release a complete set of updated policies (in full or summary form). For other updates, please refer to the Executive Summary of Key 2014 Updates and Process.

If you have any questions, please contact ca-research@issgovernance.com.

BOARD

Corporate Governance Issue:
Voting on Director Nominees in Uncontested Elections

Definition of Independence - TSX and TSXV

Current Definition:

Inside Director (I)

- Employees of the company or its affiliates[1];
- Non-employee officer of the company if he/she is among the five most highly compensated;
- Current interim CEO;
- Beneficial owner of company shares with more than 50 percent of the outstanding voting rights.

Affiliated Outside Director (AO)

- Former executive with the company within the last three years (excluding CEO);
- Former CEO (no cooling-off period);
- Former interim CEO if the service was longer than 18 months or if the service was between 12 and 18 months and the compensation was high relative to that of the other directors (5x their pay) or in line with a CEO's compensation[2];
- Former executive of the company, an affiliate, or a firm acquired within the past three years;
- Executive of a former parent or predecessor firm at the time the company was sold or split off from parent/predecessor (subject to three-year cooling off other than CEO);
- Executive, former executive within last three years, general or limited partner of a joint venture or partnership with the company;
- Relative[3] of current executive officer[4] of the company;
- Relative of a person who has served as an executive officer of the company within the last three years;
- Currently provides (or a relative provides) professional services to the company or to its officers;
- Currently employed by (or a relative is employed by) a significant customer or supplier[5];
- Is (or a relative is) a trustee, director or employee of a charitable or non-profit organization that receives grants or endowments from the company;
- Has (or a relative has) a transactional relationship with the company excluding investments in the company through a private placement;
- Has a contractual/guaranteed board seat and is party to a voting agreement to vote in line with management on proposals being brought to shareholders;
- Founder[6] of the company but not currently an employee;
- Board attestation that an outside director is not independent.

Independent Directors (IO)

- No material ties to the corporation other than board seat.

[1] "Affiliate" includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.
[2] ISS will look at the terms of the interim CEO's compensation or employment contract to determine if it contains severance pay, long-term health and pension benefits, or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was under way for a full-time CEO.
[3] Relative refers to immediate family members including spouse, parents, children, siblings, in-laws, and anyone sharing the director's home.
[4] Based on the definition of Executive Officer used in Multilateral Instrument 52-110.

[5] If the company makes or receives annual payments exceeding the greater of $200,000 or 5 percent of recipient's gross revenues (the recipient is the party receiving proceeds from the transaction).
[6] The operating involvement of the Founder with the company will be considered. Little or no operating involvement may cause ISS to deem the Founder as an independent outsider.
[7] "Material" is defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.

Key Changes:

- The Definition has been reformatted for ease of reference.
- Criteria 1.3 now clarifies that, in addition to a current interim CEO, any current interim executive on the board of directors will be designated as an Inside Director.
- Criteria 1.4 further clarifies to include voting power distributed within a group (i.e. a family).
- Section 2 Affiliated Outside Directors now contains two separate sections to define the independence status of a Former or Interim CEO who would be subject to no cooling off period in the first section and the independence status of any other Non-CEO Executives who would be subject to a three year cooling off period, under various scenarios.
- Criteria 2.1 clarifies that a former CEO of an affiliate of the Company will be designated as an Affiliated Outside Director.
- Criteria 2.2 eliminates a pay multiple that would be considered high relative to other directors. As directors' pay has continued to increase year over year along with directors' duties and responsibilities, the former multiple established as guidance several years ago may no longer be relevant.
- Criteria 2.5 has been added to clarify that a former interim executive on the board, other than a former interim CEO, may be deemed an Affiliated Outsider in certain circumstances.
- Criteria 2.11 has been included to identify different situations where professional services are provided to the issuer that may affect a director's independence.
- The footnote definition of Executive Officer has been clarified with further detail.

Rationale for Update:

The update to the definition codifies and clarifies policy application with respect to certain criteria that relate to controlling entities, former interim executives on the board, and the definition of Executive Officer for this purpose; it also delineates those Affiliated Outside Directors that would be subject to a cooling off period versus those who would not be subject to any cooling off period under ISS policy.

Please see the new 2014 ISS Canadian Definition of Independence below:

2014 ISS Canadian Definition of Independence

1. Inside Director (I)

1.1 Employees of the Company or its affiliates[i];

1.2 Non-employee officer of the Company if he/she is among the five most highly compensated;

1.3 Current interim CEO or any other current interim executives;

1.4 Beneficial owner of Company shares with more than 50 percent of the outstanding voting rights (this may be aggregated if voting power is distributed among more than one member of a group)[ii].

2. Affiliated Outside Director (AO)

<u>Former/Interim CEO</u>

2.1 Former CEO of the company or its affiliates (no cooling off period).

2.2 Former interim CEO if the service was longer than 18 months or if the service was between 12 and 18 months and the compensation was high relative to that of the other directors or in line with a CEO's compensation[iii] at that time.

2.3 CEO of a former parent or predecessor firm at the time the Company was sold or split off from the parent/predecessor (no cooling off period).

<u>Non-CEO Executives</u>

2.4 Former executive of the Company, an affiliate, or a firm acquired within the past three years;

2.5 Former interim executive if the service was longer than 18 months or if the service was between 12 and 18 months, an assessment of the interim executive's terms of employment including compensation relative to other directors or in line with the top five NEOs at that time.

2.6 Executive of a former parent or predecessor firm at the time the Company was sold or split off from parent/predecessor (subject to three year cooling off);

2.7 Executive, former executive within the last three years, general or limited partner of a joint venture or partnership with the Company;

<u>Relatives</u>

2.8 Relative[iv] of current executive officer[v] of the Company;

2.9 Relative of a person who has served as an executive officer of the Company within the last three years;

<u>Transactional, Professional, Financial, and Charitable Relationships</u>

2.10 Currently provides (or a relative provides) professional services to the Company or to its officers;

2.11 Is (or a relative is) a partner, controlling shareholder or an employee of, an organization that provides professional services to the Company, to an affiliate of the Company, or to an individual officer of the Company or one of its affiliates.

2.12 Currently employed by (or a relative is employed by) a significant customer or supplier[vi];

2.13 Is (or a relative is) a trustee, director or employee of a charitable or non-profit organization that receives material[vii] grants or endowments from the Company;

2.14 Has (or a relative has) a transactional relationship with the Company excluding investments in the Company through a private placement;

<u>Other Relationships</u>

2.15Has a contractual/guaranteed board seat and is party to a voting agreement to vote in line with management on proposals being brought to shareholders;

2.16 Founder[viii] of the Company but not currently an employee;

<u>Board Attestation</u>

2.17 Board attestation that an outside director is not independent.

3. Independent Directors (IO)

3.1 No material ties to the corporation other than board seat.

[i] "Affiliate" includes a subsidiary, sibling company, or parent company. ISS uses 50 percent control ownership by the parent company as the standard for applying its affiliate designation.

[ii] Under this definition, officers of an entity and/or its affiliates holding more than 50% of the outstanding voting rights will be considered insiders.
[iii] ISS will look at the terms of the interim CEO's compensation or employment contract to determine if it contains severance pay, long-term health and pension benefits or other such standard provisions typically contained in contracts of permanent, non-temporary CEOs. ISS will also consider if a formal search process was underway for a full-time CEO.
[iv] Relative refers to immediate family members including spouse, parents, children, siblings, in-laws and anyone sharing the director's home.
[v] Executive Officer will include: the CEO or CFO of the entity; the president of the entity; a vice-president of the entity in charge of a principal business unit, division or function; an officer of the entity or any of its subsidiary entities who performs a policy making function in respect of the entity; any other individual who performs a policy-making function in respect of the entity; or any executive named in the Summary Compensation Table.
[vi] If the company makes or receives annual payments exceeding the greater of $200,000 or 5 percent of recipient's gross revenues (the recipient is the party receiving proceeds from the transaction).
[vii] "Material" is defined as a standard of relationship (financial, personal or otherwise) that a reasonable person might conclude could potentially influence one's objectivity in the boardroom in a manner that would have a meaningful impact on an individual's ability to satisfy requisite fiduciary standards on behalf of shareholders.
[viii] The operating involvement of the Founder with the company will be considered. Little or no operating involvement may cause ISS to deem the Founder as an independent outsider.

Persistent Problematic Audit Related Practices - TSX

Current Recommendation: Case-by-case based on analytical framework.

Key Changes: Addition of a policy to vote case-by-case on members of the Audit Committee and potentially the full board if problematic accounting practices are identified that rise to a level of serious concern.

New Recommendation:

Vote case-by-case on members of the Audit Committee and potentially the full board if adverse accounting practices are identified that rise to a level of serious concern, such as: accounting fraud; misapplication of applicable accounting standards; or material weaknesses identified in the internal control process.

Severity, breadth, chronological sequence, and duration, as well as the company's efforts at remediation, should be examined in determining whether withhold votes are warranted.

Rationale for Update:

In recent proxy seasons, there has been disclosure of material weaknesses in the internal control process at certain TSX reporting issuers, some of which have been remediated within a reasonable period of time, while others have not been remediated for an unacceptably lengthy period of time. The policy update codifies ISS' analytical approach with respect to those cases that would be determined to raise serious concern with respect to the Audit Committee's oversight of the implementation by management of effective internal controls over the accounting process and financial reporting. Also, the Audit Committee has the primary responsibility for selecting and overseeing the external audit firm that would be expected to raise concerns related to problematic accounting practices, misapplication of applicable accounting standards, or material weaknesses in the company's internal controls, as well as whether fraudulent activity is uncovered during the course of the audit assignment.

Voting on Directors for Egregious Actions - TSX and TSXV

Current Recommendation: Under extraordinary circumstances, withhold from directors individually, one or more committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to the director(s)' service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Key Changes:

- Indicating by footnote examples of risk oversight failures;
- Specifying that hedging of company stock by directors and/or executives is considered a material failure of risk oversight.

New Recommendation: Under extraordinary circumstances, withhold from directors individually, one or more committee members, or the entire board, due to:

- Material failures of governance, stewardship, risk oversight[1] or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to the director(s)' service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

Rationale for Update:

Companies must comply with applicable legal and regulatory statutes, such as anti-bribing laws; and avoid actions that may result in the companies being sanctioned or fined by the regulators or the court.

Personal hedging, while legally permitted, is a strategy to offset or reduce the risk of price fluctuations for an asset or equity. Stock-based compensation or open market purchases of company stock should serve to align executives' or directors' interests with those of shareholders. Therefore, hedging of company stock through covered call, collar, or other derivative transactions severs the ultimate alignment with shareholders' interests. Any amount of hedging permitted is considered a material risk oversight failure.

While the policy update addresses several types of risk oversight failure, the clarification with respect to hedging activities is timely and appropriate given that ISS has identified a number of companies that expressly permit hedging activities by senior executives and in some cases, directors, and that outstanding hedging positions have now been identified in disclosure documents. Failure to address hedging activities is viewed by many shareholders as an overall failure of governance, stewardship, and risk oversight. Ultimately, the Board is responsible for identifying principal risks and the Board Chair is responsible for the overall process involved in the work of the Board.

[1] Examples of failure of risk oversight include, but are not limited to: bribery; large or serial fines or sanctions from regulatory bodies; significant adverse legal judgments or settlements; or hedging of company stock.

Board Responsiveness - TSX and TSXV

Current Recommendation: Case-by-case based on analytical framework.

Key Changes: Addition of a policy to address the Board's failure to act on a majority of withheld votes from director nominees, and failure to act on majority supported shareholder proposals. Disclosed board response and rationale will be taken into consideration.

New Recommendation: In keeping with Canadian market expectations and improvements to provide shareholders with the ability to affect board change, a lack of board response to shareholder majority votes or majority withhold votes on directors is unacceptable and would result in one of the following:

Generally withhold from continuing individual directors, committee members, or the continuing members of the entire board of directors if:

- At the previous board election, any director received more than 50 percent withhold votes of the votes cast under a majority voting/director resignation policy and the Nominating Committee[2] has not required that the director leave the board after 90 days, or has not provided another form of acceptable response to the shareholder vote, which will be reviewed on a case-by-case basis;
- At the previous board election, any director received more than 50 percent withhold votes of the votes cast under a plurality voting standard and the company has failed to address the issue(s) that caused the majority withheld vote; or
- The board failed to act[3] on a shareholder proposal that received the support of a majority of the votes cast For and Against at the previous shareholder meeting.

Rationale for Update:

As indicated at the beginning of the guidelines for Voting on Director Nominees in Uncontested Elections, board responsiveness is a fundamental principle that should apply when determining votes on director nominees.

Significant change continues to occur in the Canadian market with the substantially increased number of reporting issuers adopting majority voting director resignation policies in 2013. As well, the TSX is in the process of updating listing rules with respect to disclosure to encourage adoption of majority voting director resignation policies and a requirement for detailed disclosure of voting results for director elections. In any event, follow-up action or response by the board is warranted in the instance where a director is not supported by a majority of the votes cast by shareholders but remains on the board at the next election. A reasonable period of time within which the board or nominating committee is expected to deal with a director resignation under these circumstances is indicated in the widely accepted version of Canadian majority-voting, director-resignation policies endorsed by the Canadian Coalition for Good Governance.

Disclosed board response and rationale will be taken into consideration in limited extraordinary circumstances in the event that a director's resignation is not accepted by the board or the concern that caused majority shareholder opposition has not been addressed. The vote recommendation will be determined on a case-by-case basis that is deemed to be in the best interests of shareholders.

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[2] Or other board committee charged with the duties of a nominating committee as specified in the company's majority voting director resignation policy.

[3] Responding to the shareholder proposal will generally mean either full implementation of the proposal or, if the matter requires a vote by shareholders, a management proposal on the next annual ballot to implement the proposal. Responses that involve less than full implementation will be considered on a case-by-case basis.

Director Attendance & Overboarding - TSX

Current Recommendation: Cautionary language in ISS' reports.

A directorsis overboarded if s/he sits on a number of boards which could result in excessive time commitments and an inability to carry out his/her oversight duties. Cautionary language will be included regarding the number of additional public company board seats held by directors if:

- The director is a CEO and sits on more than 2 outside public company boards in addition to his/her own company.
- The director is an outside professional director and sits on more than 6 public company boards in total.

National Policy 58-201 Corporate Governance Guidelines state that they are not meant to be prescriptive and that issuers are encouraged to consider the guidelines in developing their own corporate governance practices. Further, they state that, "The Policy provides guidance that has been formulated to be sensitive to the realities of the greater numbers of small companies and controlled companies in the Canadian corporate landscape." NP 58-201 does not address the number of boards appropriate for directors but simply instructs that the board should appoint a nominating committee and that one of the committee's duties should be to, "consider whether or not each new nominee can devote sufficient time and resources to his or her duties as a board member."

2010 Building High Performance Boards published by the Canadian Coalition for Good Governance indicates that, "directors who hold a full-time executive position should have only one or two outside public company directorships … and that directors who are not employed full time should generally hold no more than four outside corporate directorships that take up a significant amount of time."

The Pension Investment Association of Canada's Corporate Governance Principles state, more generally, that, "In order for directors to devote the required amount of time to their board responsibilities, they must limit the number of other directorships that they accept." But PIAC does not specify what an acceptable number might be, presumably in recognition of Canada's more flexible comply-or-explain governance regime.

Key Changes: Withhold recommendations on individual directors who are overboarded and where these directors have demonstrated poor attendance.

New Recommendation:

Director Attendance: Generally withhold from an individual director nominee if:

- The company has not adopted a majority voting policy AND the individual director has attended less than 75 percent of the board and committee meetings[4] held within the past year without a valid reason for these absences;
- The company has adopted a majority voting policy AND the individual director has attended less than 75 percent of the board and committee meetings held within the past year without a valid reason for the absences AND a pattern of low attendance exists based on prior years' meeting attendance.

Director Overboarding:

[4] If a withhold is based on meeting attendance for board meetings only due to lack of disclosure on committee meeting attendance, then this will be specified in ISS' report.

Irrespective of whether the company has adopted a majority voting policy, the director is overboarded[5] AND the individual director has attended less than 75 percent of his/her respective board and committee meetings held within the past year without a valid reason for these absences.

Cautionary language will be included in ISS reports where directors are overboarded regardless of attendance.

Rationale for Update:

Directors must be able to devote sufficient time and energy to a board in order to be effective representatives of shareholders' interests. While experience gained by directors on multiple public company boards is highly valued, as director responsibilities continue to become increasingly complex, time commitments required for board and key committee memberships are also rising. As such, a balance between insight gained by a director's participation on different boards and a reasonable number of commitments that provides the director with sufficient time for the preparation for, attendance at, and effective participation in board and committee meetings is warranted.

A director isconsidered to be overboarded if s/he sits on a number of boards that could result in excessive time commitments and hamper his/her ability to carry out his/her oversight duties. Definitions of overboarded vary. The U.S.-based National Association for Corporate Directors (NACD), for example, maintains that directors are "busy" if they are employed full time and serve on more than three or four boards (two outside directorships for sitting CEOs) or if they are retired and sit on more than six boards. ISS generally defines “overboarded" as: a CEO of a public company who sits on more than 2 outside public company boards in addition to the company of which he/she is CEO, or a director who is not a CEO of a public company and sits on more than 6 public company boards in total.

For the Canadian market, ISS currently applies cautionary language in our reports regarding overboarded directors. Based on ISS data for TSX reporting issuer annual meetings that occurred between January and June of 2013, roughly one-quarter of directors would be considered overboarded under a strict definition.

Within the Canadian market, which is based on a “comply-or-explain” regulatory regime of suggested best practices, there are mixed investor views on the appropriateness of evaluating directors’ ability to contribute based solely on the number of boards on which they serve. Feedback has indicated that overboarding in conjunction with other governance concerns, such as unacceptably low board and committee meeting attendance, may be a better indicator of a director’s inability to commit the necessary time and attention to the increasing demands of a board seat and may also provide an opportunity for board renewal. There are also mixed views on the need to include service on venture company boards as these start-up companies are, for several reasons, seen to require less time and effort of board directors when compared to TSX reporting issuers. Given this feedback, a double-triggered overboarding policy is deemed appropriate for the Canadian market.

[5] "Overboarded" is defined as: a CEO of a public company who sits on more than 2 outside public company boards in addition to the company of which he/she is CEO (withholds would only apply on outside boards these directors sit on), OR the director is not a CEO of a public company and sits on more than 6 public company boards in total.

SHAREHOLDER RIGHTS & DEFENSES

Corporate Governance Issue:
Advance Notice Requirement for Director Nominations - TSX and TSXV

Current Recommendation: Vote case-by-case on proposals to adopt an Advance Notice Board Policy or to adopt or amend bylaws containing or adding an advance notice requirement, giving support to those proposals which provide a reasonable framework for shareholders to nominate directors by allowing shareholders to submit director nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review.

To be reasonable, the company's deadline for notice of shareholders' director nominations must not be more than 65 days and not fewer than 30 days prior to the meeting date. If notice of annual meeting is given fewer than 50 days prior to the meeting date, a provision to require shareholder notice by close of business on the 10th day following first public announcement of the annual meeting is supportable. In the case of a special meeting, a requirement that a nominating shareholder must provide notice by close of business on the 15th day following first public announcement of the special shareholders' meeting is also acceptable.

In general, support additional efforts by companies to ensure full disclosure of a dissident shareholder's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review any proposed director nominees.

Key Changes: The addition of language indicating that the board must be able to waive any provision of the advance notice requirement which may provide nominating shareholders with legal recourse if denied access to the ballot, and inclusion of a paragraph to identify potentially problematic agreements requested from potential director nominees in advance that go beyond the stated purpose of an Advance Notice provision and may impede the ability of such nominees, if elected, to affect positive board and corporate governance change.

New Recommendation:

Vote case-by-case on proposals to adopt an Advance Notice Board Policy or to adopt or amend bylaws containing or adding an advance notice requirement, giving support to those proposals which provide a reasonable framework for shareholders to nominate directors by allowing shareholders to submit director nominations as close to the meeting date as reasonably possible and within the broadest window possible, recognizing the need to allow sufficient notice for company, regulatory, and shareholder review, and to allow the board to waive any provision of the advance notice requirement.

To be reasonable, the company's deadline for notice of shareholders' director nominations must not be more than 65 days and not fewer than 30 days prior to the meeting date. If notice of annual meeting is given fewer than 50 days prior to the meeting date, a provision to require shareholder notice by close of business on the 10th day following first public announcement of the annual meeting is supportable. In the case of a special meeting, a requirement that a nominating shareholder must provide notice by close of business on the 15th day following first public announcement of the special shareholders' meeting is also acceptable.

In general, support additional efforts by companies to ensure full disclosure of a dissident shareholder's economic and voting position in the company so long as the informational requirements are reasonable and aimed at providing shareholders with the necessary information to review any proposed director nominees within a timely manner.

Generally, vote against if:

- The board may only waive a portion of the advance notice provisions under the policy or by-law, in its sole discretion; or
- The company requires any proposed nominee to deliver a written agreement wherein the proposed nominee acknowledges and agrees that he or she will comply with all policies and guidelines of the company that are applicable to directors.

Corporate Governance Issue:
Enhanced Shareholder Meeting Quorum for Contested Director Election - TSX and TSXV

Current Recommendation: Case-by-case based on analytical framework.

Key Changes: Addition of a policy on Enhanced Shareholder Meeting Quorum.

New Recommendation:

Generally vote against new By-Laws or amended By-Laws that would establish two different quorum levels which would result in implementing a higher quorum solely for those shareholder meetings where common share investors seek to replace the majority of current board members ("Enhanced Quorum").

Rationale for Update:

With Enhanced Quorum, the ability to hold a shareholders' meeting is subject to management's pre-determination that a contested election to replace a majority of directors is the singularly most important corporate issue, thus justifying a significantly higher shareholder (or proxy) presence before the meeting can commence. From a corporate governance perspective, this higher threshold appears to be inconsistent with the view that shareholder votes on any voting item should carry equal importance and should therefore be approved under the same quorum requirement for all items.

Companies have indicated in examples to date that Enhanced Quorum is not designed to block the potential consequence of a majority change in board memberships. In the absence of Enhanced Quorum being met, the affected shareholder meeting will be adjourned for up to 65 days. At the reconvened meeting, any shareholders present in person or by proxy will constitute a quorum and the contested director election can proceed at that time.

Notwithstanding the equality of all voting issues, shareholders may question the benefits of a delayed shareholder meeting resulting from a requirement of a 50 percent quorum for the initial meeting, when no quorum requirement is needed for the reconvened meeting for the conduct of the same business, which must also be weighed against the costs of a rescheduled meeting and potential board entrenchment concerns.

COMPENSATION

Corporate Governance Issue:
Executive Pay Evaluation: Advisory Votes on Executive Compensation – Management Proposals - TSX

Pay for Performance Evaluation

Current Methodology: The determination of long-term pay for performance alignment is a two-step process: step one is a quantitative screen, which includes a relative and absolute analysis on pay for performance, and step two is a qualitative assessment of the CEO's pay and company performance. A P4P disconnect will be determined as follows:

Step I: Quantitative Screen

Relative:

1. The Relative Degree of Misalignment (RDA) is the difference between the company's TSR rank and the CEO's total pay rank within a peer group[6], measured over a one-year and three-year period;
2. Multiple of Median (MOM) is the total compensation in the last reported fiscal year relative to the median compensation of the peer group; and

Absolute:

3. The CEO pay-to-TSR Alignment (PTA) over the prior five fiscal years, i.e., the difference between absolute pay changes and absolute TSR changes during the prior five-year period (or less as company disclosure permits);

Key change: Change the calculation of the first peer group alignment measure, the relative degree of alignment (RDA), from a 40/60 weighted average of 1- and 3-year RDA measures to a single, annualized RDA measure for the 3-year measurement period (or shorter period if pay and performance data are not available for all three years).

New Methodology: The determination of long-term pay for performance alignment is a two-step process: step one is a quantitative screen, which includes a relative and absolute analysis on pay for performance, and step two is a qualitative assessment of the CEO's pay and company performance. A P4P disconnect will be determined as follows:

Step I: Quantitative Screen

Relative:

1. The Relative Degree of Alignment (RDA) is the difference between the company's annualized TSR rank and the CEO's annualized total pay rank within a peer group[7], each measured over a three-year period or less if pay or performance data is unavailable for the full three years;

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[6] The peer group is generally composed of 11-24 companies that meet the following criteria:

- Revenue/assets between 0.25X and 4X the subject company's size;
- In the closest GICS industry group (8-digit, 6-digit, 4-digit, or 2-digit) to the subject company's GICS category; and
- Market Cap between 0.25X and 4X of the company's market cap expanded out to four market cap buckets (micro, small, mid, and large) as needed.

In exceptional cases, peer groups may be determined on a customized basis.

2. Multiple of Median (MOM) is the total compensation in the last reported fiscal year relative to the median compensation of the peer group; and

Absolute:

3. The CEO pay-to-TSR Alignment (PTA) over the prior five fiscal years, i.e., the difference between absolute pay changes and absolute TSR changes during the prior five-year period (or less as company disclosure permits).

Rationale for Update:

A number of reasons are prompting this update:

- Under the revised methodology, ISS will calculate the difference between the company's TSR rank and the CEO's total pay rank within a peer group, as measured over a three-year period (or as many full fiscal years that the company has been publicly traded and disclosed pay data). The current relative degree of alignment (RDA) is the weighted average of two measures: the RDA over a one-year period, and the RDA over a three-year period, weighted 40 percent and 60 percent, respectively. Because the most recent year is included in both measures, the result is that this most recent year is the most heavily weighted. Under the new model, each year of TSR will be weighted equally and calculated to produce the annualized TSR for the measurement period, thus providing a smoother performance measure that does not over-emphasize any particular year during the measurement period. Relevant performance and pay in particular years will be addressed during the qualitative phase of ISS' review, as applicable.

- A single measure provides a better view on long-term pay and performance alignment and avoids being overwhelmed by periods of volatility and mean-reversion, especially. The revised formula also better addresses companies that have at least two years, but not three years, of TSR data available; under the current model, only one year of pay and performance can be assessed in such cases.

- The relative aspect of RDA better matches a single measure. This is best illustrated by an example: a company might experience significant declines in years 1 and 2 of a three year period, then partially rebound in the final year. This apparent "strong" performance in the final year might be the 100th percentile relative to peers, and thus dominate the longer-term poor performance: even if 3-year performance lagged all peers (0th percentile), the weighted arithmetic average performance rank under the current methodology would be at the 40th percentile. The new methodology would better reflect poor overall long-term performance. The same effect would be seen if the reverse is true – two years of high TSR followed by a year of significant decline in TSR.

- Using a single 3-year measure also diminishes certain issues relative to the timing of equity awards. Many companies grant equity early in the fiscal year, before the corresponding performance year. A longer-term "average" performance (matched to average pay) helps alleviate any potential timing mismatch.

- A single measure, and its longer term, better aligns with our stated principles of evaluating long-term shareholder performance.

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[7] The peer group is generally comprised of 11-24 companies that meet the following criteria:

- Revenue/assets between 0.25X and 4X the subject company's size;
- In the closest GICS industry group (8-digit, 6-digit, 4-digit, or 2-digit) to the subject company's GICS category; and
- Market Cap between 0.25X and 4X of the company's market cap expanded out to four market cap buckets (micro, small, mid, and large) as needed.

In exceptional cases, peer groups may be determined on a customized basis.

Board Communications and Responsiveness

Current Recommendation: Consider the following on a case-by-case basis when evaluating ballot items related to executive pay:

- Poor disclosure practices, including: insufficient disclosure to explain the pay setting process for the CEO and how CEO pay is linked to company performance and shareholder return; lack of disclosure of performance metrics and their impact on incentive payouts; no disclosure of rationale related to the use of board discretion when compensation is increased or performance criteria or metrics are changed resulting in greater amounts paid than that supported by previously established goals.
- Board's responsiveness to investor input and engagement on compensation issues, for example: failure to respond to majority-supported shareholder proposals on executive pay topics, or failure to respond to concerns raised in connection with significant opposition to MSOP proposals.

Key Changes: Adding a bullet point under the "Board Communication and Responsiveness section" of the Management Say on Pay policy specifying the threshold vote support that would be considered significant opposition below which an issuer will be expected to provide disclosure of steps taken in response, such as evidence of engagement, revising problematic pay practices, or more rationale on pay practices.

New Recommendation: Consider the following on a case-by-case basis when evaluating issues related to executive pay:

- Poor disclosure practices, including: insufficient disclosure to explain the pay setting process for the CEO and how CEO pay is linked to company performance and shareholder return; lack of disclosure of performance metrics and their impact on incentive payouts; no disclosure of rationale related to the use of board discretion when compensation is increased or performance criteria or metrics are changed resulting in greater amounts paid than that supported by previously established goals.
- Board's responsiveness to investor input and engagement on compensation issues, including:
    - Failure to respond to majority-supported shareholder proposals on executive pay topics;
    - Failure to respond to majority-opposed previous say-on-pay proposal; and
    - Failure to respond to the company's previous say-on-pay proposal that received support of less than 70 percent of votes cast taking into account the ownership structure of the company.

Examples of board response include, but are not limited to: disclosure of engagement efforts regarding the issues that contributed to the low level of support, specific actions taken to address the issues that contributed to the low level of support, and more rationale on pay practices.

Rationale for Update:

The advisory nature of "Say on Pay" in Canada is an opportunity for companies to hear the views of investors. It is an effective form of feedback for the company on its approach to executive compensation. Hence, although the vote is non-binding, companies should consider the feedback of investors when formulating compensation policy and procedures. This feedback may signal that more engagement with investors is required.

Due to the voluntary nature of Say on Pay in Canada, vote support levels have typically been above 80 percent, as the largest and best governed companies have been the first to offer an advisory vote on executive compensation. Vote support that falls below 70 percent but above 50 percent is seen to be an indication of substantial shareholder disenchantment with a company's executive compensation structure, practices or disclosure. Institutional shareholders have indicated that vote support below 70 percent demands a response from the board, which may include shareholder engagement, changes in executive compensation structure or practices, or improved disclosure and rationale to support compensation decisions.

Therefore, an addition to the current policy in order to address vote support of less than 70 percent on the previous year's say on pay proposal is warranted. Issuers should follow-up with investors and provide a response explaining the actions undertaken by the board as a result of low shareholder support.

Corporate Governance Issue: Equity Compensation Plans - TSX

Non-Employee Director Participation/Director Limit Considerations

Current Recommendation:

Non-Employee Director Participation

Vote against discretionary non-employee director participation in management equity compensation plans.

RATIONALE: Due to the continuing use of options in compensation plans in Canada, we have not opposed the use of options for outside directors per se, but have tried to address potential governance concerns by ensuring a reasonable limit on grants to independent non-employee directors who are charged with overseeing not only a company's compensation scheme but also corporate governance and long-term sustainability. To this end, ISS policy established an acceptable range for aggregate non-employee director option grants of 0.25 percent to 1 percent of the outstanding shares. A company was expected to fall within this range based on its size and stage of development, so that larger, more mature companies would be limited to something closer to 0.25 percent, and smaller companies with less cash and much lower share prices would be at the upper end of the range and have a larger pool of shares, options typically, from which to draw. This range was originally established based on an underlying policy that an upper limit of $1 million worth of stock acquired by means of option grants for each director over the life of a typical 10-year plan seemed reasonable to prevent misalignment of purpose.

Director Limit Considerations

Generally vote against an equity compensation plan proposal which provides that: (i) non-employee director participation exceeds our established 1 percent director pool limit, or (ii) non-employee director participation exceeds a $100,000 per director per year maximum within the 0.25 percent to 1 percent of the outstanding shares range, taking into account:

- The overall mix of pay elements (cash vs. equity)
- The type of equity awards granted (deferred stock units, restricted stock, stock options)
- Director shareholding requirements and how they are achieved (stock granted outright until a target is met vs. some "skin in the game" in the form of directors taking DSUs in lieu of cash fees)
- Rigor of mandatory and disclosed vesting requirements (i.e., vest when director leaves the board)
- Overall company performance, as well as director pay levels vs. peers.
- Generally vote against an equity plan proposal if the $100,000 per director per year equity award maximum is exceeded.
- Generally vote against individual equity grants to non-employee directors outside of an equity compensation plan if:
    - The director's annual grant would exceed the above per director maximum other than a reasonable one-time grant upon joining the board.

RATIONALE: ISS will assess the non-employee director component (or reserve) of equity-based compensation plans based on the ISS compensation model (binomial) award value that is used for employee compensation purposes. This will be consistent with our methodology for establishing the value of awards for employee participants and the plan generally.

The proposed maximum for non-employee director equity grants including options will then factor in: the difference between options and full value awards (i.e., time-vesting restricted stock); option terms (five, seven, or 10 years usually); share price volatility; expected forfeiture rate; and any other criteria factored into a binomial type evaluation.

Using the binomial equity award value, we have established a maximum non-employee director participation limit of the lesser of: (i) an aggregate reserve of 1 percent of the shares outstanding for all non-executive directors; and (ii) an annual equity award value of $100,000 per director. Equity award refers to options, restricted stock, deferred stock units, or any other equity grant made outside of or under an equity compensation plan, other than shares granted or taken in lieu of cash fees.

However, there may be director pay structures that have addressed institutional investor concerns so that directors truly have substantial “at risk” pay that achieves alignment of directors’ interests closely with those of shareholders, therefore some limited flexibility in implementing this guideline is necessary.

Key Changes:

- Update the current non-employee director participation limit in equity plans to increase the permitted value limit on forms of equity granted to non-employee directors (NEDs) other than stock options.
- Clarify that there are now different ISS policy limits for option-based and share-based (non-option) equity compensation award grants to NEDs.
- Simplify the language for clarity and understanding.

New Recommendation:

Non-Employee Director Participation

Vote against a management equity compensation plan that permits discretionary non-employee director participation.

Director Limit Considerations

Generally vote against an equity compensation plan proposal where:

- The non-employee director aggregate share reserve under the plan exceeds the ISS established maximum limit of 1 percent of the outstanding common shares; or
- The equity plan document does not specify an <u>annual individual</u> non-employee director grant limit with a maximum value of (i) $100,000 worth of stock options in the case of a stock option or omnibus plan, or (ii) $150,000 worth of shares in the case of an equity plan that does not grant stock options.

Individual Non-Employee Director Grants

Generally vote against individual equity grants to non-employee directors in the following circumstances:

- In conjunction with an equity compensation plan that is on the agenda at the shareholder meeting if voting against the underlying equity compensation plan; and
- Outside of an equity compensation plan if the director’s annual grant would exceed the above individual director limit.

Shares taken in lieu of cash fees and a one-time initial equity grant upon a director joining the board will not be included in the maximum award limit.

Rationale for Update:

To address investor concerns related to discretionary or unreasonable non-employee director participation in management equity compensation plans, ISS established an acceptable limit on grants to such directors who are not only charged with the administration of a company's compensation program but are also responsible and accountable for the company's overall corporate governance and long term sustainability. The established acceptable range for aggregate non-employee director option grants is 0.25 percent to 1 percent of the outstanding shares. Within that range an individual annual director limit was established based on market practice.

The current annual $100,000 per director limit for participation in the company's equity incentive plans has not been updated since it was introduced. The general view of investors is that director compensation should adequately reward directors for their experience, expertise, and time devoted to the company. Given regulatory updates and increased shareholder engagement activity, the role of non-employee directors has expanded substantially. Therefore, an increase in the level of non-employee director share based (non-option) compensation may be appropriate to attract and retain qualified and experienced directors.

Canadian institutional investors do not generally support stock options as an appropriate form of equity compensation for non-employee directors, and, at a minimum, require that option grants to NEDs be substantially restricted. ISS has maintained the previously established maximum limit on stock option grants to NEDs. However, based on current market practice, an updated annual individual non-employee director share-based (non-option) award limit of $150,000 may be reasonable taking into consideration the increased demands on directors.

Corporate Governance Issue: Repricing Proposals - TSX and TSXV

Current Recommendation: Generally vote against proposals to reprice outstanding options, unless:

Repricing is part of a broader plan amendment that substantially improves the plan and provided that the following conditions are met:

- A value-for-value exchange is proposed;
- The five top paid officers and all non-employee directors are excluded;
- Options exercised do not go back into the plan OR the company commits to an annual burn rate cap.

RATIONALE: Security Based Compensation Arrangements Section 613(h)(iii) of the TSX Company Manual requires security holder approval (excluding the votes of securities held directly or indirectly by insiders benefiting from the amendment) for a reduction in the exercise price or purchase price or an extension of the term of an award under a security based compensation arrangement benefiting an insider of the issuer notwithstanding that the compensation plan may have been approved by security holders.

ISS has long opposed option repricing and believes that any proposal to reduce the price of outstanding options including those held by non-insiders, should be approved by shareholders before being implemented (see discussion under Plan Amendment Provisions). Market deterioration, in and of itself, is not an acceptable reason for companies to reprice stock options and/or reset goals under performance plans.

The extension of option terms is also unacceptable. Options are not meant to be a no-risk proposition and may lose their incentive value if the term can be extended when the share price dips below the exercise price. Shareholders approve option grants on the basis that recipients have a finite period during which to increase shareholder value, typically five to ten years. As a company would not shorten the term of an option to rein in compensation during profitable bull market runs, it is not expected to extend the term during a market downturn when shareholders must suffer a decrease in shareholder value.

Key Changes: Removal of the exception for which ISS would approve a repricing or option exchange proposal to reprice outstanding options and inclusion of an illustration of what constitutes repricing for the purpose of the policy.

New Recommendation: Generally vote against proposals to reprice outstanding options. The following and any other adjustments that can be reasonably considered repricing will generally not be supported: reduction in exercise price or purchase price, extension of term for outstanding options, cancellation and reissuance of options, substitution of options with other awards.

RATIONALE: Security Based Compensation Arrangements Section 613(h)(iii) of the TSX Company Manual requires security holder approval (excluding the votes of securities held directly or indirectly by insiders benefiting from the amendment) for a reduction in the exercise price or purchase price or an extension of the term of an award under a security based compensation arrangement benefiting an insider of the issuer notwithstanding that the compensation plan may have been approved by security holders.

ISS has long opposed option repricing. Market deterioration is not an acceptable reason for companies to reprice stock options.

Although not required by TSX rules, ISS believes that any proposal to reduce the price of outstanding options, including those held by non-insiders, should be approved by shareholders before being implemented (see discussion under Plan Amendment Provisions).

The extension of option terms is also unacceptable. Options are not meant to be a no-risk proposition and may lose their incentive value if the term can be extended when the share price dips below the exercise price. Shareholders approve option grants on the basis that recipients have a finite period during which to increase shareholder value, typically five to ten years. As a company would not shorten the term of an option to rein in compensation during, for example, a commodities bull market run, it is not expected to extend the term during a market downturn when shareholders suffer a decrease in share value.

Rationale for update:

Institutional investors have long opposed repricing of outstanding options, and, in most cases, have publicly disclosed policies that oppose all forms of repricing. Based on institutional investor feedback in recent years, the repricing of outstanding stock options is not supported by any ISS client canvassed on the subject.

Additionally, the Canadian Coalition for Good Governance ("CCGG") has consistently emphasized its stand on repricing of options. The 2013 Executive Compensation Principles state that, "*If there is a significant sustained drop in the company's share price, the board should not directly or indirectly 're-price' stock options. Option exercise prices are not increased when* *share prices rise, and they should not be reduced when share prices drop – this tenet is considered fundamental to aligning the interests of management with the interests of long-term shareholders."*

Therefore, with a view to more accurately articulate current policy application in ISS policy guidelines, it is in the best interests of institutional clients and issuers to remove the exceptions from the current repricing policy language.

DISCLOSURE/DISCLAIMER