Canada Policy – Director Compensation

Background and Overview

As non-employee director compensation schemes in Canadian companies increase in quantum and complexity, institutional investors have expressed concern regarding certain highly problematic practices relating to director compensation.

In particular, the issuance of excessive inducement grants to non-employee directors can create problematic incentives which may compromise an otherwise independent director's judgement or foster divergent incentives between those directors who have recently received such awards and those who have not. Similarly, the issuance of performance-based equity awards (e.g. performance share units or PSUs) to non-employee directors may increase the risk of aligning otherwise independent directors' interests with those of management rather than the interests of shareholders.

Key Changes under Consideration

On a case-by-case basis, generally vote withhold for the chair of or other members of the committee responsible for director compensation (or, where no such committee has been identified, the board chair or full board) where director compensation practices which pose a risk of compromising a non-employee director's independence or which otherwise appear problematic from the perspective of shareholders have been identified, including:

- excessive inducement grants issued upon the appointment or election of a new director to the board (consideration will be given to the form in which the compensation has been issued and the board's rationale for the inducement grant);
- performance-based equity grants to non-employee directors which could pose a risk of aligning directors' interests away from those of shareholders and toward those of management; and
- other problematic practices relating to director compensation.

Intent and Impact

Based on discussions with institutional investors, this policy is intended to address their expressed concerns by highlighting and opposing highly problematic non-employee director compensation practices and to reflect best practices within the Canadian market as outlined by the Canadian Coalition for Good Governance's 2011 *Director Compensation Principles*.

As these problematic practices are generally employed by a limited number of outlier companies, the policy is not expected to have wide-ranging impact but will highlight only those most problematic cases.

Request for Comment

- At what point should an inducement grant be considered excessive (e.g. a multiple of the value of routine individual director equity grants, a multiple of total average individual director compensation, a fixed value, etc.)?

- In the case of an inducement grant which may be considered problematic due to quantum, are there any terms or provisions which, if affixed to the grant, would mitigate such concerns? Please explain.

- In addition to excessive inducement grants to new non-employee directors and the issuance of performance-based equity awards to non-employee directors, are there other significant problematic non-employee director pay practices which ISS should highlight and oppose?