Compensation at Externally Managed Issuers (Canada)

Background and Overview

Externally-managed issuers (EMIs) typically pay fees to outside firms in exchange for management services. In most cases, some or all of the EMI's executives are directly employed and compensated by the external management firm.

In the cases reviewed where a management services agreement is in place, the companies only provided disclosure on the aggregate amount of fees paid and minimal or incomplete executive compensation information; rendering a pay-for-performance analysis or a complete review of incentive compensation impossible.

In Canada, say-on-pay resolutions are not mandatory, and none of the currently identified Canadian EMIs had voluntarily included a say-on-pay resolution on their most recent ballots. In the absence of a say-on-pay resolution, ISS policy is to assess compensation committee members or other board members if deemed responsible for compensation oversight.

Effective June 30, 2014, all non-controlled TSX-listed companies are required to have a majority voting policy for uncontested director elections. Directors who fail to be elected by a majority of votes cast would have to tender their resignation, requiring them to step down if the board accepts the resignation.

One commonly expressed view is that the inadequate disclosure related to EMIs is a regulatory issue and/or an engagement opportunity for institutional investors, and that disclosure quality alone in this instance is not a strong foundation for withholding votes from directors; especially now with the advent of majority voting where the possibility of removing directors has increased substantially.

Key Changes under Consideration

ISS Canada is proposing to a policy update to recommend case-by-case on say on pay resolutions where provided, individual directors, committee members, or the entire board as appropriate, where an issuer is externally-managed and has provided minimal or no disclosure about its management services agreements and how senior management is compensated. Factors taken into consideration may include but are not limited to:

- The size and scope of the management services agreement
- Executive compensation in comparison to issuer peers and/or similarly structured issuers
- Overall performance
- Related party transactions
- Board and committee independence
- Conflicts of interest and process for managing effectively

- Disclosure and independence of the decision-making process involved in the selection of the management services provider
- Risk mitigating factors included within the management services agreement such as fee recoupment mechanisms
- Historical compensation concerns
- Executives' responsibilities, and
- Other factors that may reasonably be deemed appropriate to assess an externally-managed issuer's governance framework.

Intent and Impact

This policy change is intended to address the evaluation of pay for performance at EMIs.

The impact of this proposal is expected to be small. ISS is currently aware of three externally-managed, TSX-listed issuers where extremely limited compensation disclosure has been provided.

Request for Comment

- Does your organization support the view that the above proposed policy approach to review a range of factors is appropriate for both director elections and say on pay resolutions at externally managed companies? If not, please explain.

- What factors should ISS also consider or perhaps remove when reviewing an EMI's compensation arrangements?