Equity Plan Scorecard (Canada)

Background and Overview

As issues around cost transparency and best practices in equity-based compensation continue to evolve, ISS proposes to update its Canadian Equity Plans policy in order to provide for a more nuanced consideration of equity plan proposals by introducing a scorecard approach.

Currently, the Canadian policy for equity plans comprises a series of pass/fail tests relating to plan cost and to three key concerns of Canadian investors:

- Non-employee director participation;
- Plan amendment provisions; and
- Repricing without shareholder approval.

While the three policy cornerstones above are proposed to continue to be overriding negative factors under the new policy, the pass/fail test for plan cost will be replaced with a model that takes into account multiple factors, both positive and negative, designed to provide a robust overview of an equity plan's strengths and weaknesses.

Feedback obtained through ongoing consultation with institutional investors in Canada and the U.S. since the 2011-2012 ISS policy cycle indicates strong support for the new approach, which incorporates the following key goals:

1. Consider a range of factors, both positive and negative, in determining vote recommendations;
2. Select factors based on institutional investors' concerns and preferences and on best practices within the Canadian market established through regulation, disclosure requirements, and best practice principles;
3. Establish relevant factor thresholds and weightings within the context of the Canadian governance landscape (separate scorecards for the S&P/TSX Composite Index and the broader TSX);
4. Ensure that key concerns addressed by policy continue to hold paramount importance (institution of overriding negative factors).

Key Changes Under Consideration

Similar to the model introduced by ISS for U.S. equity plans for 2015, ISS proposes to adopt a "scorecard" model (Equity Plan Scorecard – "EPSC") for Canadian TSX equity plans that considers a range of positive and negative factors to evaluate equity incentive plan proposals. A company's total EPSC score, in combination with the overriding factors already established in Canadian policy, will determine whether a "For" or "Against" recommendation is warranted.

Key features of the proposed Canadian EPSC include the following:

(i) Scorecard factors evaluated will fall under three main categories:
   1) Plan Cost: The total estimated cost of the company's equity plans relative to industry/market cap peers, measured by the company's estimated Shareholder Value Transfer (SVT) in relation to peers and considering both:
      - SVT based on new shares requested plus shares remaining for future grants, plus outstanding unvested/unexercised grants; and
      - SVT based only on new shares requested plus shares remaining for future grants.
   2) Plan Features:
      - Reasonable share dilution from equity plans relative to market best practice.
      - Absence of problematic change-in-control (CIC) provisions;
      - No financial assistance to plan participants for the exercise or settlement of awards;
      - Public disclosure of the full text of the plan document; and
   3) Grant Practices:
      - Reasonable three-year average burn rate relative to market best practices;
      - Meaningful time vesting requirements for the CEO's most recent equity grants (three-year lookback);
      - The issuance of performance-based equity to the CEO;
      - A clawback provision applicable to equity awards; and
      - Post-exercise or post-settlement share-holding requirements (Composite Index only).

(ii) In addition to the above, plans will continue to be assessed using ISS' Canadian policies regarding non-employee director participation, plan amendment provisions, and repricing without shareholder approval.

(iii) Factors and weightings will be keyed to company size and status using separate models for the S&P/TSX Composite Index and the non-Composite TSX. Special Situations versions of both models will be applied where historic grant data are unavailable (e.g. recent IPOs or emergences from bankruptcy).

Intent and Impact

The EPSC policy for equity plan proposals is intended to significantly iterate ISS' current Canadian policy by providing a more nuanced approach to evaluating plan cost, plan features, and historic grant practices. This will allow shareholders greater insight into rising governance concerns, such as the implementation of risk-mitigating mechanisms, the strength of vesting provisions, and the use of performance-based equity, while also providing added assessments of longstanding concerns relating to equity plans such as burn rate and dilution.

The proposed policy is not designed to increase or decrease the number of companies that would receive adverse vote recommendations. Rather, by assessing these factors in combination, the EPSC is designed to facilitate a more holistic approach to vote recommendations. For example, a plan where cost is nominally higher than a company's allowable cap may receive a favourable recommendation if sufficient positive factors are present. Conversely, a plan where cost is nominally lower than the allowable cap may ultimately receive a negative recommendation if a preponderance of scorecard factors demonstrates adverse qualities.

Plans will, however, continue to be subject to the scrutiny of overriding negative factors reflecting ISS' current policies regarding problematic non-employee director participation, insufficient plan amendment provisions, repricing without shareholder approval, and other egregious practices. Plans permitting these unacceptable practices will continue to receive an "against" recommendation.

Request for Comment

- Are there certain factors outlined above in our proposed scorecard approach that should be more heavily weighted when evaluating equity plan proposals? Please specify and explain.
- Do you see any unintended consequences from shifting to a scorecard approach for TSX equity plans? If yes, please specify.