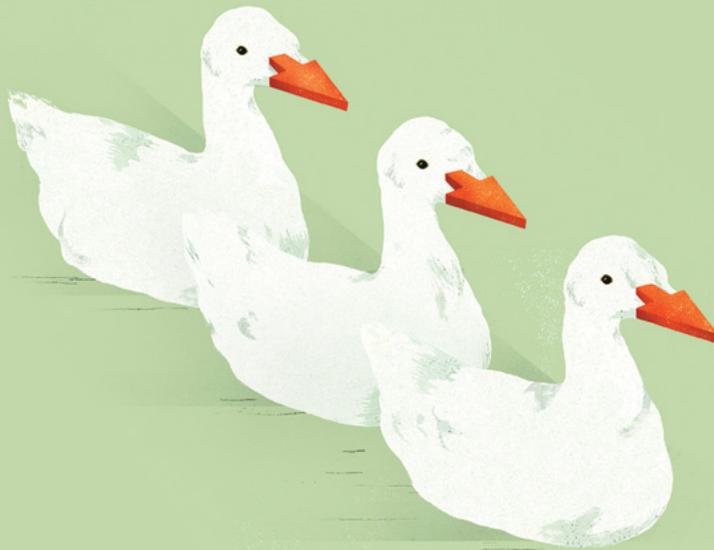


2012 Developments in Canadian Corporate Governance

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2012 saw the Toronto Stock Exchange (TSX) revamp director election practices by requiring listed issuers to elect all directors annually, prohibiting slate voting, requiring issuers which have not adopted a majority voting policy for the election of directors to explain why and proposing that all listed issuers have majority voting policies.





Meanwhile, the Canadian Securities Administrators (CSA) responded to perceived deficiencies in respect of the corporate governance of Canadian public companies operating in emerging markets by publishing the results of a review of the practices of certain of these companies and, later in the year, issuing guidance for such companies and their boards. Late in the year, final rules were issued to implement notice-and-access in lieu of paper delivery of copies of proxy materials to shareholders. Compensation was a key focus of shareholders and support for company say-on-pay resolutions declined only slightly overall, although a few issuers received less than 70% support. Diversity and risk oversight were important board topics, as was shareholder activism (which is discussed elsewhere in this Capital Markets Review). Meanwhile, not-for-profit boards began preparing for the transition to new not-for-profit federal and provincial corporate statutes. Set out below is a brief overview of these various 2012 developments.

Director Elections for TSX Issuers

Leapfrogging over other jurisdictions worldwide, the TSX announced changes to its listing requirements (effective December 31, 2012) which will prohibit staggered boards and slate voting for directors by requiring that directors be elected annually and that voting for directors be on an individual basis. The TSX believes that these changes will increase director accountability and provide insight into the level of support for each director.

The new annual director election requirements apply only where the listed securities are eligible to vote for directors. Structured finance vehicles, limited partnerships and other issuers which have listed only non-voting securities will not be affected by this change. If securityholder approval is required to amend a listed issuer's constating documents to permit annual elections for directors, the listed issuer must seek approval of such changes at its annual meeting in 2013. If securityholders do not approve the changes at the annual meeting, the annual director election requirement will not apply to the listed issuer, but the listed issuer will be required to seek securityholder approval to permit annual director elections at least once every three years thereafter.

Canadian securities laws require reporting issuers which are not venture issuers to file on SEDAR promptly following each securityholder meeting the outcome of any vote by securityholders and, if a ballot vote is conducted, the number or percentage of votes

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- prohibit staggered boards, by requiring that directors be elected annually, and
- prohibit slate voting for directors by requiring that voting for directors be on an individual basis.

In the face of growing concerns surrounding certain issuers with significant operations or control based in emerging market jurisdictions listed in the Canadian capital markets, the OSC released its Emerging Markets Issuer Review, identifying 4 principal concerns:

- Corporate Governance Practices;
- Corporate Structures;
- Related Party Transactions; and
- Risk Management and Internal Controls.



cast for, against or withheld from voting. The TSX now requires issuers also to press release the portion of such report that relates to the election of directors.

The TSX changes require listed issuers to disclose in their proxy circular for any shareholder meeting at which directors are to be elected whether the listed issuer has a majority voting policy for the election of directors for non-contested meetings. The TSX does not prescribe the form of any majority voting policy or define what a majority voting policy is. However, if an issuer's listed securities carry the right to vote for the election of directors and the listed issuer does not have a majority voting policy, the listed issuer must explain in the circular why not and describe its practices for electing directors. Also, the listed issuer must notify the TSX if at any director election a director received a majority of "withhold" votes.

The TSX has also issued proposed changes that would require all listed issuers to adopt majority voting for the election of directors at annual meetings. Alternatively, listed issuers may adopt a majority voting policy that requires (1) a director who receives a majority of "withhold" votes to tender his or her resignation subject to its acceptance by the board, and (2) the board to consider the resignation and disclose by news release within 90 days thereafter the board's decision whether or not to accept that resignation and its reasons. In addition, the TSX proposes that where directors are elected at a meeting by a show of hands vote, the press release announcing the result of the director election must also provide the number of securities voted by proxy in favour or withheld for each director.

Emerging Market Issuer Review

In the face of notable concerns that began to surface involving certain issuers with significant operations or control based in emerging market jurisdictions, notably China, that were listed for trading and raising capital in the Canadian capital markets, the Ontario Securities Commission (OSC) began to conduct a review in 2011. In March, 2012, the results of the review were reported in OSC Staff Notice 51-719 *Emerging Markets Issuer Review* (EM Review). The OSC identified four principal concerns arising in connection with emerging market issuers listed on Canadian stock exchanges:

- Corporate Governance Practices – The OSC was concerned with the level of engagement by boards and audit committees in their oversight of management, and the sense of responsibility for the stewardship of an emerging market issuer with public investors. The OSC was also concerned with the extent of knowledge of boards and audit committees of the cultural and business practices of the jurisdictions in which the emerging market issuer operated.
- Corporate Structures – The complexity of certain corporate structures did not appear to be either clear or necessary to support the emerging market issuer's underlying business model in the view of the OSC. The quality of controls in place to manage the risks arising from the complexity of the structure was also a concern.



- Related Party Transactions – The OSC was concerned with the extent and frequency of related party transactions and the quality of the management and board processes in place to identify and approve these transactions. The OSC EM Review also revealed deficiencies in the completeness and appropriate clarity of related party disclosures.
- Risk Management and Internal Controls – The OSC commented that many risks were often not appropriately identified, understood or managed by the board. It also found that risk disclosures by the issuers were not specific or as relevant as they should have been to be informative to investors.

The EM Review resulted in a number of recommendations, which generally involve the development of guidance, best practices or enhanced vigilance to support compliance with existing Canadian corporate governance and disclosure requirements.

Following the EM Review, in September, 2012 the OSC published a guide for issuers operating in emerging markets, OSC Staff Notice 51-720 *Issuer Guide for Companies Operating in Emerging Markets* (EM Guide). The EM Guide was published to provide specific guidance to help boards meet the regulatory and investor expectations of participants in Ontario's capital markets and provide assistance to emerging market issuers and their directors and management regarding governance and disclosure practices in light of the unique challenges they face.

Specifically, the EM Guide was designed to:

- highlight to emerging market issuers and their directors and management potential areas of risk or red flags that may warrant further scrutiny;
- set out questions that directors and management of emerging market issuers should consider when deciding how to address risks of doing business in emerging markets; and
- outline the OSC's expectations regarding compliance with existing disclosure requirements.

The OSC acknowledges in the guide that board members of emerging market issuers may face a steeper learning curve to understand the emerging market issuer's business and operating environment. Nevertheless, the OSC is clear that all board members of Canadian reporting issuers, regardless of where the board members are located and where the business operations are located, are required to adhere to Canadian regulatory requirements.

The EM Report and EM Guide provide useful guidance on the standards the OSC expects of emerging market issuers and their boards¹.

¹ The TSX and TSX-V have also published for comment a joint consultation paper on emerging market issuers.



Notice and Access

Reporting issuers other than investment funds will be able to satisfy requirements under Canadian securities laws to send materials to, and seek voting instructions from, their securityholders under new notice and access procedures for meetings occurring on or after March 1, 2013 pursuant to amendments issued in November, 2012 to National Instrument 51-102 *Continuous Disclosure Obligations* and National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*, and the related companion policies. Dissidents and others who solicit proxies will also be able to use notice and access to comply with proxy solicitation requirements.

Under these new notice and access rules, it will no longer be necessary for an issuer to send paper copies of its proxy circular and annual financial statements to its securityholders. Instead, the securityholder will receive a form of proxy or voting instruction form, along with a notice of the meeting that sets out a brief description of the matters to be voted, and instructions on how to access the proxy materials electronically (or to request a paper copy of the materials) and on how to provide voting instructions.

Reporting issuers may use stratification and include a paper copy of the proxy circular in the notice packages sent to certain categories of securityholders. In addition, reporting issuers may include in the notice package copies of the annual financial statements to be approved at the meeting and related MD&A.

Reporting issuers who have a class of securities registered under section 12 of the *Securities Exchange Act of 1934* who are required to file reports under section 15(d) of that Act, who are not registered or required to be registered as an investment company under the *Investment Company Act of 1940* and who are required to comply with U.S. proxy rules (which would not include Canadian issuers which are “foreign private issuers” under U.S. securities laws) are permitted to follow U.S. notice and access rules in lieu of compliance with proxy solicitation requirements under Canadian securities laws.

Although notice and access is available under Canadian securities laws, the ability of an issuer to take advantage of this alternative may be restricted under the issuer’s constating documents, governing statute or other legislation. For those that are able to make use of it, notice and access is expected to substantially reduce the volume of material printed and mailed, and decrease the cost of conducting a shareholder vote.

Executive Compensation

The Canadian Securities Administrators adopted amendments to Form 51-102F6 *Statement of Executive Compensation* under National Instrument 51-102 *Continuous Disclosure Obligations* which implement certain changes to executive compensation disclosure requirements effective for financial years ending on or after October 31, 2011. Among other things, the changes restrict the circumstances where companies may omit disclosure of performance goals and require additional disclosure respecting (i) the experience of compensation



committee members relevant to service on the committee, (ii) risks associated with the corporation's compensation practices, (iii) significant changes to be made to the corporation's compensation policies in the following year, (iv) whether or not executives or directors may hedge their holdings of corporation stock, and (v) fees paid to any independent compensation consultant and whether director pre-approval is required before the consultant may provide other services to the corporation.

In light of the prescriptive nature of these requirements, reporting issuers have struggled to provide disclosure which is meaningful to securityholders. This year, many issuers adopted a practice of including a supplemental report or letter from the compensation committee or its chair to provide a more focussed, high-level summary of the reporting issuer's compensation practices.

The number of Canadian companies voluntarily providing their shareholders with an advisory vote on executive compensation (say-on-pay) continued to increase in 2012, with over 99 Canadian issuers now doing so according to the Shareholder Association for Research and Education. In 2012, four issuers received less than 70% support on their say-on-pay resolution, thereby likely triggering a review next year by Institutional Shareholder Services (ISS) of the company's response to the vote, whether the issues underlying the voting result are recurring or isolated and the company's ownership structure prior to ISS making its recommendations.

Canadian issuers are also considering proposed changes to NYSE and Nasdaq listing requirements respecting factors to be considered in assessing the independence of compensation committee members and the responsibilities of such committees to consider the independence of compensation advisors whose advice is provided to the committee as these changes are expected to come into effect early in 2013.

Board Topics - Diversity and Risk Oversight

Women, visible minorities, persons with disabilities and aboriginal peoples continue to be underrepresented on Canadian corporate boards. In December 2011, the Institute of Corporate Directors released a position paper showing considerable support for greater board diversity among Canadian corporate directors and advocating for the adoption of formal diversity policies, reflecting practices in the United Kingdom and Australia.

In response to requests for increased disclosure respecting risk oversight by boards in the financial sector and with respect to executive compensation practices, boards have been considering ways to improve the process for identifying and managing key business risks, assessing interconnectivities among risks and setting the organization's appetite for risk. In July, 2012, the Canadian Institute of Chartered Accountants issued "A Framework for Board Oversight of Enterprise Risk" involving a nine step process to help directors to



identify and address critical risks, understand how risks are interconnected and their compounding effects, and develop appropriate risk appetite levels for the issuer.

CONTRIBUTORS

New Federal and Ontario Not-for-Profit Corporate Legislation

A new Canada *Not-for-Profit Corporations Act* (New Federal Act) was proclaimed into force on October 17, 2011. The New Federal Act provides federal not-for-profit corporations with a new set of rules that are modern, flexible and better suited to the needs of today's not-for-profit sector and include much needed modernization of corporate governance for the not-for-profit sector. The prior legislation had not been updated since 1919. The New Federal Act contemplates a three year transition period ending October 17, 2014 during which not-for-profit corporations will need to prepare new articles and by-laws and obtain member approval. 2012 saw many federal not-for-profit corporations begin the transition process.

The New Federal Act is closely modelled on the *Canada Business Corporations Act* (CBCA) and modernizes many of the duties of not-for-profit directors so they are now consistent with the CBCA. For example, not-for-profit directors have the duty to act honestly and in good faith with a view to the best interests of the not-for-profit corporation, and to exercise the care, diligence and skill of a reasonably prudent person. Directors of not-for-profits will also now have the ability to pass unanimous written resolutions in lieu of holding meetings.

Ontario has also updated its not-for-profit legislation - the new Ontario *Not-for-Profit Corporations Act, 2010* (New Ontario Act) received Royal Assent on October 25, 2010 and is expected to be proclaimed into force July 1, 2013. Similar to the New Federal Act, the New Ontario Act is designed to modernize existing not-for-profit legislation and harmonize it with for-profit corporate legislation. The New Ontario Act will provide for a three year transition period during which Ontario not-for-profit corporations will need to prepare new articles and by-laws and obtain member approval.