NYSE: Corporate Governance Guide

Canada

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Corporate governance in Canada is founded on a system of legal rules that involve a single-tier board model similar to, and influenced by, the systems seen in the United Kingdom and the United States. Overlaying this is an extensive array of best practices that are promoted by securities regulators, stock exchanges, institutional shareholder groups, the media, and professional bodies. These practices have been influenced by the high proportion of public corporations in Canada that have a dominant or controlling shareholder, either through equity ownership or the ownership of multiple voting rights, and the economic clout and organization of Canadian institutional investors, including the Canadian Coalition for Good Governance (CCGG), a national institutional investor organization that has pursued an organized program of advocating its views on best practices without resorting to proxy battles. Legal rules are less prescriptive than in the United States, generally taking a comply-or-explain approach reflective of practice in the United Kingdom and other jurisdictions. While the Supreme Court of Canada recently affirmed that a board of directors in Canada owes its fiduciary duties to the corporation rather than any single constituency, pressure from the media, investor rights advocates, and other groups has led to voluntary adoption of many practices by companies that are not addressed by legal rules and that reflect the desire on the part of particular stakeholders to have a more direct say on matters of importance to the corporation.

Many of the topical issues in corporate governance in Canada today reflect a particular effort on the part of shareholders, both institutional and activist, to exercise more influence. Institutional investors have lobbied for greater voting influence through the adoption of majority voting for directors and say-on-pay and other voting initiatives. These efforts and the impact of increased shareholder activism in Canada in recent years has prompted a re-examination of Canadian proxy rules and the impact of proxy advisory organizations by regulators, and the adoption of advance notice provisions for nomination of directors by companies. In addition, the Ontario Securities Commission (OSC) is proposing to introduce new disclosure rules respecting the representation of women on boards and director tenure.

Majority voting and individual voting for directors

Effective June 30, 2014, all companies listed on the Toronto Stock Exchange (TSX) are required to have majority voting for directors, whether through adoption of a policy or under their constating documents or governing statute, although there is an exemption for majority-controlled companies (where a single person or company owns 50 percent or more of the voting securities). Since December 31, 2012, TSX companies have been required to provide for individual voting for directors rather than slate voting and to disclose whether or not they had adopted a majority voting policy and, if not, explain why. TSX companies are also required to issue a press release of director election results promptly following the shareholder meeting. Majority voting means that in a director election that is not contested, where more votes are withheld from voting on the election of a director than are voted in favor, the director must promptly tender a resignation and the board must announce within 90 days whether or not the resignation is accepted. By the fall of 2011, when the TSX conducted a survey of 200 of its listed companies, approximately 76 percent of those surveyed had voluntarily adopted a majority voting policy.

The question whether to extend majority voting requirements and individual voting for directors more broadly has been studied by the OSC and is currently being considered as part of a public consultation on a request for comments on the Canada Business Corporations Act published by Industry Canada on December 11, 2013 (the CBCA Consultation). While individual voting for directors has widespread support and is the common practice in Canada, it is unclear to what extent majority voting will be extended beyond TSX listed companies. Circumstances where directors have failed to receive majority approval have been very rare but are increasing. There are also concerns about the impact it may have on the ability of smaller companies to recruit talented directors and the possibility of "failed elections"—where no directors are elected or an insufficient number of directors are elected with the attributes necessary to meet statutory director residency requirements or requirements to have an audit committee made up of at least three independent directors.

Say-on-pay

Canadian companies are not subject to an obligation to hold a nonbinding, advisory shareholder vote on executive compensation (say-on-pay). Although many other jurisdictions have passed legislation mandating say-on-pay votes, in some cases on a binding basis, and although a consultation paper issued by the OSC in January 2011 and the recent CBCA Consultation have sought views on whether to require advisory say-on-pay votes, there are no proposals to adopt similar legislation in Canada.

There are many reasons why say-on-pay is not required in Canada, although none are determinative. Executive compensation levels have, in general, been lower than in other jurisdictions. Canadian companies have a long history of engagement with their shareholders on matters of interest, including executive compensation practices. Executive compensation disclosure practices have improved. Institutional shareholder support for say-on-pay has not been unanimous, as one large pension fund, the Ontario Teachers' Pension Plan, has stated that it does not favor say-on-pay voting. Canadian companies generally were less adversely affected by the most recent economic downturn than companies in other countries. The widespread use of individual voting for directors means that shareholders can express dissatisfaction with compensation practices by withholding votes for the election of members of the compensation committee without needing a separate say-on-pay vote.

Despite the absence of any legislative requirement, the number of companies that have voluntarily adopted say-on-pay has gradually increased every year. Adopters have been almost exclusively larger companies listed on the TSX. Although the number of say-on-pay adopters has increased each year, average approval levels have gradually declined, and the number of companies with either failed say-on-pay votes or approval levels below 70 percent has increased. Such trends, as well as media reports following the few instances where say-on-pay voting has highlighted excessive pay concerns at a few companies, have slowed the rate of voluntary adoption by Canadian companies.

Canadian proxy rules

The increased emphasis on voting by shareholders on dilutive transactions, individual voting for directors, voluntary adoption of say-on-pay, and shareholder activism has placed increasing pressure on the Canadian proxy voting system. Gaps in the system were highlighted in 2012 when TELUS Corporation's proposal to eliminate its dual-class share structure was opposed by a US hedge fund that used an empty voting strategy to oppose TELUS's initial proposal.

The Canadian Securities Administrators (CSA) issued a consultation paper in August 2013 regarding the proxy voting system in Canada. The paper sought feedback on the system for determining voting entitlements for securities held through intermediaries on behalf of beneficial owners, including consideration of the impact of share lending, documentation errors, and the nature and extent of over-reporting and over-voting. It also sought information on the possibility of implementing an end-to-end vote confirmation system so that beneficial owners could receive assurance that their votes were received and recorded as cast. A roundtable discussion on the issues with representatives from the issuer, institutional investor, brokerage, and proxy advisory communities was held in January 2014. Separately, the CBCA Consultation is also examining facilitation of board and shareholder communications, including increased transparency of share ownership.

Any changes to the Canadian proxy rules are unlikely to change certain features that distinguish it from other jurisdictions, including:

1. the ability of a company to send materials directly to beneficial owners who do not object to disclosure of their identity and holdings
2. the ability of a company to set a deadline for the deposit of proxies up to two business days before the date of the shareholder meeting
3. the practice of companies and dissidents not having joint access to beneficial owner voting responses prior to the meeting.

Proxy advisory firms

In response to complaints respecting the activities and influence of proxy advisory firms, the CSA published a consultation paper in June 2012. The paper focused on concerns respecting potential conflicts of interest, a perceived lack of transparency, potential inaccuracies and limitations on the ability of companies to engage with proxy advisory firms, corporate governance implications, and the extent of reliance by institutional investors on the recommendations provided by proxy advisory firms.

Comments were divided. Issuers and their advisers agreed with the concerns identified, while institutional investors and proxy advisory firms noted the useful and cost-effective services they provide. Proxy advisory firms also indicated that they have appropriate policies and procedures in place to address the concerns identified.

In light of the feedback received, the CSA decided to adopt a policy-based approach of providing guidance on recommended practices and disclosure for proxy advisory firms. The guidance addresses the need for proxy advisory firms to identify, manage, and mitigate conflicts of interest, implement appropriate practices to promote transparency and accuracy of vote recommendations, and communicate with their clients regarding their practices.

Advance notice provisions

Canada has experienced increased shareholder activism as large well-financed activist funds have pursued shareholder activist campaigns as a business. This increase in activity has prompted Canadian companies to examine their defensive strategies. Many have recently adopted a long-standing US practice of including a company by-laws provision requiring advance notice to the company of any intent to propose nominees for director. Only a handful of Canadian companies had adopted such requirement prior to 2012. However, many Canadian companies have done so since.

Although modeled on US provisions, Canadian advance notice provisions require a person to provide notice of director nominees not more than 65 and not less than 30 days prior to the meeting date, compared to a minimum of 60 to 90 days or 90 to 120 days prior notice under US provisions. While such provisions have largely been supported by institutional shareholders and proxy advisers, increasing concern that certain aspects of such policies may be unduly restrictive are prompting institutional investors to re-examine their views.

Women on boards

Effective December 31, 2014, many public companies in Canada will be required to comply with new disclosure requirements which seek to encourage them to increase the number of women on boards and in senior management.

The springboard for this new rule was a consultation paper issued by the OSC in July 2013. In January 2014, following receipt of over 92 written submissions and a public roundtable discussion, all of which generally supported the initiative, the OSC issued proposed rule changes. In July 2014, securities regulatory authorities in many of the other provinces and territories in Canada republished the proposed rule changes for comment. The final version of the disclosure rule was issued in October 2014 by securities regulators in all jurisdictions in Canada other than Alberta, British Columbia, Prince Edward Island, and Nunavut.

Under the new disclosure rule, a company subject to continuous disclosure requirements in one or more of the participating jurisdictions, other than a company listed on the TSX Venture Exchange or investment fund, is required to disclose annually the number and percentage of women directors and women who are executive officers, together with any targets the company has adopted regarding the number or percentage of women in such positions and the progress made in achieving those targets. The company is also required to disclose whether it has a written policy for the identification and nomination of women candidates for director or explain why it does not. If such a policy has been adopted, the company must provide a summary of the policy and its objectives, implementation measures, the annual and cumulative progress made on achieving the objectives, and whether, and if so how, the board or nominating committee measures the policy's effectiveness. The company must disclose whether it considers the level of representation of women on the board in identifying and nominating candidates for director and the level of representation of women in executive officer positions when making executive officer appointments, or explain why it does not. Companies are also required to disclose whether or not the company has adopted term limits for board service or other board renewal mechanisms and, if not, why not.

Conclusion

While Canadian corporate governance rules take a comply-or-explain approach instead of adopting prescriptive rules, most companies not only choose to comply with such standards but also voluntarily adopt best practices that go well beyond them.

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Published by White Page Ltd, in association with the New York Stock Exchange, 'NYSE Corporate Governance Guide' has been developed as a timely resource to help listed companies address key corporate governance issues including:

- Navigating the changing landscape of corporate governance
- Selecting and developing a high-quality board
- Implementing risk-management controls
- Overseeing a succession plan for senior management
- Communicating effectively with shareholders
- Assembling a comprehensive ethics and compliance program

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