Goodmans LLP

New Disclosure Rules and Guidance Related to the 2017 Proxy Season

Reporting issuers in Canada are subject to continuous disclosure obligations imposed by securities laws and the rules of stock exchanges. From time to time, the securities regulators and stock exchanges revise these disclosure rules or publish guidance to clarify points that may be ambiguous in the rules themselves. In addition, proxy advisory firms such as Institutional Shareholder Services Inc. and Glass Lewis & Co. publish annual voting guidelines, providing issuers with guidance on what the advisors consider best practices for disclosure. Finally, the Canadian Coalition for Good Governance publishes an annual "best practices" guideline for disclosure by reporting issuers and additional policies relating to specific matters.

Overview

The purpose of this update is to, among other things:

- discuss areas where the Canadian Securities Administrators (CSA) or the Ontario Securities Commission (OSC) have provided new guidance in respect of continuous disclosure and proxy rules;
- summarize proposed changes to the disclosure and proxy rules under the Toronto Stock Exchange (TSX) Company Manual (the "**Company Manual**");
- discuss the areas on which the CSA or OSC have indicated an intention to focus during their 2017 reviews of public disclosure;
- identify changes in Institutional Shareholder Services Inc. ("**ISS**") and Glass Lewis & Co. ("**Glass Lewis**") proxy voting guidelines applicable for the 2017 proxy season; and
- discuss any other relevant guidance and best practices that have emerged since the last proxy season.

This update does not provide a comprehensive description of the content of the documents referenced below. It is advisable to review each of those documents in connection with the preparation of this year's annual proxy materials. Copies of any or all of the materials can be provided by any member of our Corporate Securities group upon request.

Summary of Relevant Updates and Guidance

The following briefly summarizes the primary updates to, and guidance in respect of, the disclosure and proxy rules for the 2017 proxy season described in this update:

Guidance and Areas of Focus for 2017

- the CSA provided the results of its 2016 continuous disclosure review;
- the CSA provided additional guidance to issuers using non-GAAP financial measures in continuous disclosure materials;
- the CSA published a review of compliance with corporate governance disclosure related to gender

diversity, as the relevant amendments to National Instrument 58-101 – *Disclosure of Corporate Governance Practices* ("**NI 58-101**") have been in force for two full years;

- the CSA released proxy voting protocols designed to enhance the accuracy, reliability and accountability of proxy voting in Canada;
- the CSA published a report on its review of cyber security related disclosure by issuers included in the S&P/TSX Composite Index;
- ISS and Glass Lewis released proxy policy updates in the areas of corporate governance standards, shareholder rights plans, executive and director compensation and audit-related matters; and
- the Canadian Coalition for Good Governance (CCGG) released its annual guide on best practices for proxy circular disclosure, as well as a position statement relating to the use of performance share units as part of executive compensation.

Changes in Disclosure and Proxy Rules

- the TSX proposed amendments to the Company Manual that, upon approval by the OSC, will, among other things, (a) require TSX-listed issuers to maintain a website for posting certain key security holder documents (the "**Website Amendments**") and (b) simplify the disclosure requirements related to security based compensation arrangements (the "**Disclosure Amendments**"); and
- the federal government introduced Bill C-25 in the Parliament of Canada, which proposes to amend the *Canada Business Corporations Act* (CBCA) with respect to director election, notice and access and gender diversity disclosure, among other matters.

Guidance and Areas of Focus for 2017

The following is a summary of the areas where the CSA and OSC have provided new guidance or have indicated they intend to focus during their subsequent reviews of continuous disclosure materials. Please refer to the text of the applicable staff notice for a full description of the guidance provided by the CSA and OSC.

CSA Staff Notice 51-346 – Continuous Disclosure Review Program Activities for the Fiscal Year Ended March 31, 2016

Staff Notice 51-346 – *Continuous Disclosure Review Program Activities for the fiscal year ended March 31, 2016* summarizes the results of CSA reviews of compliance by reporting issuers with certain continuous disclosure provisions of securities legislation during the year ended March 31, 2016 ("**Continuous Disclosure Review Program**"). The Continuous Disclosure Review Program focused on deficiencies relating to financial statements, management's discussion and analysis (MD&A), material contracts, management information circulars and annual information forms, among other things. The following is a summary of the hot button findings of the Continuous Disclosure Review Program:

(i) Financial Statement Deficiencies

Market Risk – Sensitivity Analysis. The CSA observed that some issuers presented sensitivity analysis that did not reflect the reasonably possible changes in the relevant risk at the date of the financial statements and/or was not meaningful in light of the current economic environment.

Contingent Considerations in Business Combinations. In certain instances, issuers failed to identify and account for contingent consideration and inappropriately accounted for settlements as a measurement-period adjustment.

Goodwill and Intangible Assets Recognized in Business Combinations. Certain issuers allocated the entire purchase price

to one intangible asset, despite disclosure indicating the presence of other identifiable intangible assets or goodwill. The CSA also found that some issuers did not explain how they determined the useful life of finite-lived intangible assets or why an intangible asset had an indefinite useful life. Some issuers incorrectly determined an indefinite useful life for an intangible asset with a finite useful life.

Functional Currency. Some issuers changed their functional currency at a time that did not correspond to a change in the underlying circumstances.

Operating Segment. The CSA noted that issuers often aggregated several operating segments into a single operating segment for reporting purposes.

(ii) MD&A Deficiencies

Liquidity and Capital Resources. Many issuers facing going concern and liquidity risks provided boilerplate discussion of liquidity and capital resources, or simply reproduced amounts from their cash flow statements without providing any analysis. The CSA also noted that issuers who refinanced or entered into new debt facilities resulting in more restrictive covenants and decreased borrowing capacity failed to discuss the actual and expected changes in the source of funds needed to meet any shortfall resulting from the decreased borrowing capacity. Additionally, issuers that had breached debt covenants or were at risk of breaching such covenants in the near term did not discuss how they intended to cure the default or address the significant risk of default.

Forward Looking Information (FLI). A number of issuers failed to provide required disclosure relating to FLI, such as updates to prior disclosed FLI in their MD&A, news releases and other continuous disclosure documents. Additionally, the CSA observed that certain issuers withdrew previously disclosed material FLI without providing the required disclosure, particularly when actual results varied negatively from previously disclosed FLI.

Overall Performance (Discussion of Operating Segments). Issuers identified segments in their MD&A that were inconsistent with those identified in their financial statements. The CSA further noted that some issuers failed to provide an analysis of financial performance by operating segment using the segment performance measures presented in the financial statements.

Investment Entities. A number of issuers relying on the investment entity definition in IFRS 10 Consolidated Financial Statements did not provide sufficient qualitative and/or quantitative information for their material investments and related investment and operating activities.

(iii) Other Regulatory Disclosure Deficiencies

Material Contracts. Some issuers made prohibited redactions in material contracts, including redactions of debt covenants and ratios in financing or credit agreements or key terms necessary for understanding the impact of the contract on the business. Issuers also failed to provide a description of the redacted information. The CSA also reported inconsistencies between material contracts filed on SEDAR and those listed as material contracts in the same issuer's annual information form.

Management Information Circular (MIC). The CSA observed that some MICs prepared in connection with a restructuring in which securities are to be changed, exchanged, issued or distributed did not provide prospectus level disclosure. The CSA further reported that certain issuers which spun out a new entity or completed a reverse take-over transaction failed to provide a full description of the proposed business and related financial information. Additionally, some issuers did not incorporate by reference the MIC related to a restructuring transaction into their material change report or the material change report did not include the required disclosure.

Annual Information Form (AIF). Issuers commonly did not provide a sufficient description of their business and the applicable risk factors in their AIF.

CSA Staff Notice 52-306 - Non-GAAP Financial Measures

The CSA revised Staff Notice 52-306 *Non-GAAP Financial Measures* to provide additional guidance to issuers using non-GAAP financial measures in continuous disclosure materials. The guidance is intended to help ensure that non-GAAP financial information does not mislead investors.

In particular, the CSA confirmed that each non-GAAP financial measure should be named in a way that distinguishes it from items under the issuer's GAAP and in a way that is not misleading. A non-GAAP financial measure is defined in the notice as a numerical measure of an issuer's historical or future

financial performance, financial position or cash flow that is not specified, defined or determined under the issuer's GAAP and is not presented in an issuer's financial statements.

Additionally, the CSA noted that if an issuer presents additional subtotals from its financial statements in a press release or other location outside of the financial statements before the financial statements are filed on SEDAR, the issuer should explain the composition of the subtotals by: (i) including a copy of the financial statement containing the additional subtotals; or (ii) reconciling the additional subtotals to the most directly comparable IFRS line item that will be presented in the financial statements.

CSA Staff Notice 58-308 – Staff Review of Women on Boards and in Executive Officer Positions – Compliance with NI 58-101

On September 28, 2016, the CSA published a review of compliance by 677 reporting issuers with the gender diversity disclosure requirements set out in NI 58-10. NI 58-101 requires non-venture issuers in all provinces and territories, except British Columbia and Prince Edward Island, to disclose certain information regarding women on boards and in executive positions.

The findings revealed a modest improvement in the number of women on the boards of non-venture issuers as compared to the results reported in the CSA's review published in September 2015. The number of issuers having at least one female executive officer has remained relatively stable. The CSA's review also reported that a number of issuers did not provide complete disclosure with respect to certain requirements of the gender diversity disclosure rules.

Issuers should expect continued scrutiny and review of their gender diversity disclosure in 2017. On December 9, 2016, Bill C-25, which proposes to amend the CBCA, completed the second reading debate stage in the Parliament of Canada. If Bill C-25 is passed into law, all public CBCA corporations will be subject to gender diversity disclosure rules similar to those currently mandated by Canadian provincial securities laws, as well as disclosure requirements regarding diversity other than gender.[1]

CSA Staff Notice 54-305 – Meeting Vote Reconciliation Protocols

Staff Notice 54-305 *Meeting Vote Reconciliation Protocols*, published by the CSA on January 26, 2017, sets out operational protocols designed to enhance the accuracy, reliability and accountability of proxy voting in Canada (the "**Protocols**").

The Protocols outline the CSA's views on appropriate roles and responsibilities of a number of key participants in the proxy voting process – including the Canadian Depository for Securities Limited (CDS), intermediaries, Broadridge and transfer agents (in their capacities as vote tabulators) – as well as operational processes these participants should adopt. The Protocols, which are fairly technical in nature, are primarily aimed at ensuring that (i) vote tabulators receive the information they require to accurately establish the voting entitlements of intermediaries such as custodians and investment dealers and (ii) vote tabulators and intermediaries establish standard communication channels to facilitate the exchange and confirmation of information relating to voting entitlements and any potential problems relating to proxies that are submitted to the tabulator.

The CSA will monitor the voluntary adoption of the Protocols during the 2017 proxy season and subsequently assess the need for new rules and guidance at that time.

For a further discussion of the Protocols, refer to our January 30, 2017 Update, *Canadian Securities Administrators Publish Final Proxy Voting Protocols*.

CSA Staff Notice 51-347 – Disclosure of Cyber Security Risks and Incidents

On January 19, 2017, the CSA published a report on its review of cyber security related disclosure by 240 issuers included in the S&P/TSX Composite Index. This review was part of a series of initiatives being undertaken by Canadian securities regulators to assist market participants in understanding, mitigating and providing effective disclosure of potential cyber security risks.

[1] Refer to the section below entitled *Bill C-25: Proposed Amendments to the CBCA* for a discussion of other important changes that could result if Bill C-25 is passed into law.

The CSA's review focused on whether and how issuers had disclosed: (i) potential impacts of cyber attacks on their businesses; (ii) the kind of material information that could be exposed as a result of attacks; and (iii) governance and cyber security risk mitigation initiatives. The review also searched for disclosure of previous cyber security incidents.

To the extent that issuers have determined that cyber security risk is a material risk, CSA Staff expect that issuers will avoid boilerplate language and provide risk disclosure that is as detailed and "entity specific" as possible.

In preparing risk factor disclosure regarding cyber security matters, the CSA expects that issuers will consider, among other things:

- the reasons they may be exposed to a potential breach;
- the source and nature of any breach;
- the potential consequences of a breach;
- insurance coverage in case of a breach;
- identifying the group or individuals responsible for the issuer's cyber security; and
- where required, apply disclosure controls and procedures under National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* to previously detected cyber security incidents.

The CSA does not expect issuers to disclose sensitive information that could compromise their cyber security risk mitigation strategies.

The CSA also reminds issuers to consider whether a specific security incident might be a material change that requires immediate disclosure or a material fact that requires disclosure as part of an issuer's ongoing reporting obligations.

For a further discussion of the cyber security disclosure review, refer to our January 24, 2017 Update, *CSA Provides Guidance on Disclosure of Cyber Security Risks*.

ISS and Glass Lewis Canadian Proxy Voting Guidelines 2017 Updates

The following is a summary of certain policy changes being adopted by ISS and Glass Lewis for the 2017 proxy season in Canada, which are also summarized in our November 29, 2016 update *ISS and Glass Lewis 2017 Proxy Season Guidelines*. For a full description of each new policy initiative, including the application of, and rationale for, those initiatives, refer to ISS' "Americas Proxy Voting Guidelines Updates – 2017 Benchmark Policy Recommendations"[2] and Glass Lewis & Co.'s "2017 Proxy Paper Guidelines - Canada"[3].

(i) Overboarded Directors

Glass Lewis' 2017 guidelines codify its existing policy on director overboarding whereby, absent a sufficient rationale that allows shareholders to evaluate the scope of a director's other commitments as well as his or her contributions to the board, it will recommend voting against:

- a director who serves as an executive officer of any public company while serving on a total of more than two public company boards; or
- any other director who serves on a total of more than five public company boards.

Glass Lewis will generally not recommend that shareholders vote against overcommitted directors at the companies where they serve as an executive, based on the belief that executives will primarily devote their attention to executive duties.

(ii) Board Responsiveness to Failed Advisory Vote on Executive Compensation

Under circumstances in which an advisory vote on executive compensation has been adopted, Glass Lewis will now recommend voting against members of the compensation

[2] Available online at: https://www.issgovernance.com/file/policy/2017-americas-iss-policy-updates.pdf

[3] Available online at: http://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_Canada.pdf.

committee if the committee fails to address shareholder concerns following a company's failure to secure majority approval of a so-called "say-on-pay" proposal.

(iii) Determination of Director Independence

ISS' existing guidelines deem certain directors who currently have (or whose relatives have) certain transactional, professional, financial and charitable relationships with an issuer to not be independent. The updated guidelines clarify that a director will not be considered independent if any of these relationships existed within the most recently completed fiscal year and/or have been identified at any time up to and including the applicable annual shareholders' meeting.

(iv) Shareholder Rights Plans

Both ISS and Glass Lewis have revised their guidelines to reflect the recent changes to Canada's takeover bid regime which, among other things, now mandates a minimum deposit period of 105 days. ISS and Glass Lewis have stated that they will not support rights plans that require bids to remain open for an initial deposit period of more than 105 days.

(v) Equity Compensation Plans

Glass Lewis will generally recommend against full-value awards plans, such as restricted share plans, deferred share plans or share award plans, that include a plan limit set at a rolling maximum of more than 5% of a company's share capital.

(vi) Director Compensation – TSX

ISS will generally recommend withholding votes for members of the committee responsible for director compensation (or, in the absence of such a committee, the board chair or full board) of TSX-listed issuers where director compensation practices pose a risk of compromising non-employee director independence or otherwise appear problematic from the perspective of shareholders. These practices include:

- excessive inducement grants issued upon the appointment or election of a new director to the board; and
- performance-based equity grants to non-employee directors which could pose a risk of aligning directors' interests toward management rather than shareholders.

(vii) Audit-Related Matters

Previously, ISS generally recommended withholding on proposals to appoint auditors and elect audit committee members if non-audit-related fees exceeded audit-related fees. In recognition of the fact that tax compliance and preparation are most economically provided by the audit firm, ISS will generally now only recommend withholding on proposals to appoint auditors and elect audit committee members if non-audit fees are greater than the sum of the audit fees, audit-related fees, and tax compliance/preparation fees. However, fees for other tax-related services such as tax advice, planning or consulting will be separated from the calculation of tax compliance and preparation fees and included in the calculation of non-audit fees. In the absence of a sufficient breakdown of amounts involved for various tax-related services, ISS will reallocate some or all of the tax-related fees to non-audit fees.

Canadian Coalition for Good Governance 2016 Updates

The CCGG made the following new suggestions, among others, in its annual best practices guide and other publications in 2016:

- *Independence of Board Chair*: The position of Chair and CEO should be held by separate individuals and the Chair should be independent of the company's management team. Where a company has a controlling shareholder, it is acceptable for the Chair to be a "related director" if the board appoints an independent lead director.
- *Director Attendance and Committee Composition*: The proxy circular should include committee composition and summarize director attendance at board and committee meetings. Additionally, an effective board renewal policy should provide for regular rotation of committee responsibilities and may also include periodic rotation of board chair responsibility if appropriate.

- *Executive Succession Planning*: The board should be aware of and monitor succession planning efforts for all critical roles in the organization. The CCGG also emphasizes the importance of the board meeting in camera, without the CEO, to discuss the CEO succession plan.

- *Executive Compensation - Performance Share Units*: CCGG is supportive of the use of appropriately structured performance share unit (PSU) plans to provide better alignment between executive pay and performance. Boards are encouraged to evaluate key performance measures over multi-year periods rather than through a number of one-year goals. Where the issuer may adjust various metrics used to determine the PSU value, the issuer should disclose, to the extent possible, the types of adjustments that can be made or have been made in the past. If a PSU plan has a minimum guaranteed level of vesting, boards should consider designating the guaranteed portion as a restricted share unit. Where minimum performance conditions are specified which, if not met, would result in a zero vesting outcome, the board should comment on the credibility of the threshold performance condition.

For a full description of all guidelines and best practices, including the application of, and rationale for, those guidelines and best practices, please refer to "CCGG 2016 Best Practices for Proxy Circular Disclosure," available online at www.ccgg.ca.

Changes in Disclosure and Proxy Rules

Amendments to the Company Manual

The Website Amendments and Disclosure Amendments summarized below, which were published by the TSX on May 26, 2016, will come into effect once approved by the OSC. While it is not clear whether the Website Amendments and Disclosure Amendments will be in force for the 2017 proxy season, issuers may decide to comply with such amendments in anticipation of the OSC's approval.

Website Amendments

The Website Amendments are intended to provide participants in the Canadian capital markets with ready access to key security holder documents. Issuers will be required to maintain a publicly accessible website posting current copies of:

- constating documents;
- corporate policies that impact meetings of security holders and voting;
- security holder rights plans;
- security based compensation arrangements; and
- certain corporate governance documents.

The Website Amendments will also permit an issuer who has adopted a majority voting policy to post a copy of such policy on its website, instead of describing the policy in its annual proxy materials sent to security holders.

Disclosure Amendments

The Disclosure Amendments are intended to simplify and enhance disclosure requirements for security based compensation arrangements ("**Compensation Arrangements**") by introducing a new form with a user-friendly table, Form 15 – *Disclosure of Security Based Compensation Arrangements* ("**Form 15**"), and:

- eliminating certain disclosure that duplicates Canadian securities law requirements or that security holders may not find meaningful (at the same time, as described above, current copies of all Compensation Arrangements will be required to be posted on an issuer's website);
- streamlining the disclosure for annual meetings at which security holder approval of the Compensation Arrangement is not being sought;
- requiring disclosure of a Compensation Arrangement's "burn rate" (i.e., the rate at which the issuer grants awards under the Compensation Arrangement) for up to the previous three years; and

- requiring enhanced disclosure regarding the number of awards outstanding (including giving effect to the maximum potential "multiplier" applicable to an award) and vesting conditions (including default provisions and whether vesting is time and/or performance based).

Issuers will be required to disclose the items in Form 15 in meeting materials for meetings where security holder approval is being sought for a Compensation Arrangement and other meetings of security holders in respect of Compensation Arrangements.

The Disclosure Amendments will not affect any requirements regarding when and how security holder approval is sought with respect to Compensation Arrangements or the requirement to pre-clear disclosure where security holder approval would be sought for a Compensation Arrangement.

Bill C-25: Proposed Amendments to the CBCA

As noted above, Bill C-25 completed its second reading in the Parliament of Canada on December 9, 2016. However, the proposed amendments are not expected to be enacted for some time, as the Bill must still pass a third reading in the House of Commons and three readings in the Senate.

The proposed amendments, among others, include:

- *Director Election Matters* – (i) enshrining majority voting into the CBCA such that a director will only be elected if the number of votes cast in his or her favour represents a majority of the total number of votes cast at the meeting; (ii) requiring the practice of "individual voting" rather than "slate voting" for directors; and (iii) shortening the maximum duration of director terms from three years to one year.

- *Notice and Access* – permitting CBCA corporations to make use of notice and access procedures available under Canadian provincial securities legislation by broadening the scope of exemptions available under the CBCA related to the requirement to deliver proxy-related materials to shareholders so that that the CBCA is consistent with applicable securities laws relating to notice and access.

- *Gender Diversity Disclosure* – requiring all public CBCA companies to comply with gender diversity disclosure rules similar to those currently mandated by Canadian provincial securities laws, as well as disclosure requirements regarding diversity other than gender (as noted above).

Some of the proposed amendments, such as those relating to individual voting and director term limits, are in fact already mandated by the TSX.

About Goodmans

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