

Proxy advisors update Canadian voting guidelines for 2024

By **Michelle Vigod, Julian Di Bartolomeo and Duncan Lurie**

Law360 Canada (January 16, 2024, 10:33 AM EST) -- Institutional Shareholder Services (ISS) and Glass Lewis are the two most prominent proxy advisory firms in North America. Proxy advisory firms provide guidance and recommendations to investors on how they should vote at corporate shareholder meetings.

Many institutional shareholders follow the recommendations from ISS and Glass Lewis since they may not have the internal resources to make informed voting decisions in respect of the shares of the public companies they invest in. Therefore, voting recommendations from these proxy advisers can be meaningful to the outcome of a shareholder vote depending on the make-up of a corporation's shareholder base. Each of ISS and Glass Lewis develop models for good governance and annually publish a framework for their voting recommendations, which cover a range of topics including, among other things, executive compensation, board diversity, environmental, social and governance matters, cyber risk, overboarding and mergers and acquisitions.

ISS and Glass Lewis recently issued updates to their respective Canadian Proxy Voting Guidelines that are relevant to Canadian issuers preparing for the 2024 proxy season. The changes include new guidance with respect to board diversity, director accountability for climate-related issues, board interlocks, audit financial expert designations and executive ownership guidelines, among other matters. The following is a high-level overview of these updates.

ISS board diversity

ISS's Canadian Proxy Voting Guidelines remain virtually unchanged for the 2024 year, apart from the formal implementation of its latest guidance concerning board diversity, which aligns the ISS Canadian S&P/TSX Composite Index policy more closely with the ISS U.S. Policy for Russell 3000 and/or S&P 1500 indices on board diversity. In accordance with the guidelines, ISS will generally recommend that shareholders vote against or withhold in respect of the chair of the nominating committee (or directors responsible for board nominations) of an S&P/TSX Composite Index company where:

- The board has no apparent racially or ethnically diverse members; and
- The company has not publicly disclosed a formal written commitment to add at least one racially diverse director at or before its next annual general meeting.

Glass Lewis



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Glass Lewis made the certain noteworthy updates that apply to Canada in its 2024 Benchmark Policy Guidelines, including the following::

- **Board accountability for climate-related issues:** Glass Lewis has advised that companies with material exposure to climate risk from their operations should provide thorough climate-related disclosure consistent with the recommendations of the Task Force on Climate-Related Financial Disclosures, and also disclose specific and clearly defined oversight responsibilities for climate-related issues. In instances where such disclosure is either absent or significantly lacking, Glass Lewis will recommend voting against responsible directors. While Glass Lewis only applied this policy to the largest emitters in 2023, beginning in 2024 it will apply this policy to TSX 60 companies operating in industries where the Sustainability Accounting Standards Board has determined that companies' greenhouse gas emissions represent a material risk.
- **Board interlocks:** Glass Lewis will generally recommend shareholders withhold votes from affiliated or inside directors who have interlocking directorships with one of the company's executives. In its latest updates, Glass Lewis has expanded its policy to clarify that it considers both public and private company boards when considering whether interlocking relationships exist. Additionally, Glass Lewis advised that other types of interlocking relationships, such as board interlocks with close family members of executives or within group companies, are reviewed on a case-by-case basis and that multiple board interlocks among non-insiders are reviewed for evidence of a pattern of poor oversight.
- **Oversight of cyber risk:** Glass Lewis has reiterated that, where a company has been materially impacted by a cyber attack, shareholders should be provided with periodic updates on the company's process towards resolving and remediating the impact of the attack. In such instances, Glass Lewis may recommend that shareholders vote against appropriate directors where the board's oversight, response or disclosures concerning cybersecurity-related issues were insufficient or not clearly communicated to shareholders.
- **Audit financial expert designation:** At a minimum, Glass Lewis expects audit committees to have at least one member who qualifies as an audit financial expert, which is intended to be a higher standard than being "financial literate" for the purposes of applicable Canadian securities laws. In its latest updates, Glass Lewis has revised the criteria by which it designates a director as an "audit financial expert", noting it would generally expect "audit financial experts" to include (i) chartered accountants, (ii) certified public accountants, (iii) current or former CFOs of a public company or corporate controllers of similar experience, (iv) current or former partners of an audit company, or (v) those having similar meaningful audit experience.
- **Human capital management:** In egregious cases where a board has failed to respond to legitimate concerns with a company's human resources practices (including labour practices, employee health and safety, employee engagement, and workforce diversity and inclusion), Glass Lewis may recommend voting against the chair of the committee tasked with oversight of governance matters, the chair of the committee tasked with oversight of ESG issues, or the chair of the board, as applicable.
- **Clawback provisions:** Current U.S. listing standards, relevant to many Canadian companies, require the return of incentive compensation paid to current and former executive officers in the event of an accounting restatement or a material correction to previous financial statements, regardless of fault or misconduct. Glass Lewis has advised that, where a Canadian company chooses to implement a clawback policy, the policy should also allow recovery of incentive compensation from current and former executives when there is evidence of problematic decisions or actions (such as material misconduct or a material reputational, operational or risk management failure), regardless of whether such decisions or actions have resulted in an accounting restatement or a correction to financial statements, as excessive risk-taking that can materially and adversely impact shareholders may not require such a restatement or correction. Notwithstanding Glass Lewis's latest guidance, Canadian issuers should be aware that clawback policies for Canadian employees are also required to comply with the requirements of applicable Canadian employment standards legislation, which vary from province to province, and may require that additional steps be taken to properly enforce recovery of incentive compensation from executives.
- **Executive share ownership:** Glass Lewis has created a new policy to formally outline its approach to executive ownership guidelines. The policy provides that companies should adopt and enforce minimum share ownership rules for named executive officers, to ensure the interests of management and long-term shareholders are aligned. Companies should provide clear disclosure in proxy documents concerning executive share ownership requirements and

how different equity awards are treated when determining a particular executive's level of ownership. Glass Lewis's view is that unearned and/or unvested performance-based awards or stock options should generally be excluded from such calculations (unless a convincing rationale is provided for their inclusion).

Glass Lewis also made a number of clarifying revisions to its existing policies, including:

- Governance following a going public transaction: Glass Lewis advised that, while it generally refrains from issuing voting recommendations immediately following an IPO, spin-out or direct listing transaction, it may recommend against board or governance committee members if a newly listed public company has approved overly restrictive governing documents, and will generally recommend against the chair of a governance committee following a going public transaction where a multi-class share structure was adopted if the board (i) did not also commit to put the multi-class structure to a shareholder vote at the first shareholder meeting following such transaction, or (ii) did not provide for a reasonable sunset of the multi-class share structure (generally seven years or fewer).
- Non-GAAP to GAAP reconciliation: Glass Lewis expanded the discussion of its approach to the use of non-GAAP (generally accepted accounting principles) financial measures in incentive programs to emphasize the need for thorough and transparent disclosure to assist shareholders in reconciling the difference between non-GAAP financial measures used in determining incentive compensation payments to executives versus comparable reported GAAP financial results. Particularly in situations where significant adjustments were applied, the lack of any such disclosure may be a factor in Glass Lewis's recommendations concerning "say-on-pay."

The updates discussed above, along with the full set of guidelines, should be carefully reviewed by Canadian issuers and their legal and professional advisers when preparing for the upcoming proxy season and future proxy seasons.

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