



**RiskMetrics Group**

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# Canadian Corporate Governance Policy

2010 Updates

November 19, 2009

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# RiskMetrics Group Canadian Corporate Governance Policy 2010 Updates

Effective for Meetings on or after Feb. 1, 2010  
Updated Nov. 19, 2009

These policy updates present changes and clarifications to RiskMetrics Group’s (“RMG”) Canadian benchmark guidelines for 2010. If new issues arise, such as shareholder proposals or regulatory developments, prior to the next formal update, RMG will adopt policies to cover such issues on an as-needed basis.

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## ROUTINE/MISCELLANEOUS

### Corporate Governance Issue: Limited Partnerships and Limited Liability Companies

**Current Coverage:** RMG has not had a policy for preparing reports for the annual and special meetings of publicly traded limited partnerships (“LPs”) and limited liability companies (“LLCs”).

**Key Change:** RMG will provide proxy voting analyses and recommendations for the meetings of *public* LPs and LLCs.

**New Coverage:** For the 2010 proxy season, RMG will generally apply its benchmark policies to meetings of publicly traded limited partnerships and publicly traded limited liability companies, and will develop specialized policies as needed.

**Rationale for Update:** Clients have requested that RMG begin delivering analyses and vote recommendations for meetings held by these types of businesses. Publicly traded limited partnerships are also called master limited partnerships (“MLPs”). MLPs distribute return on equity to partners (also called unitholders) on a regular basis. As such, distributable cash flow, not net earnings, drives the value of the partnerships units. Most MLPs do not submit director elections for shareholder approval.

Publicly traded limited liability companies may adopt a distributable cash model like an MLP or a capital appreciation plus dividends model like a corporation.



## BOARD

### Corporate Governance Issue: Voting on Director Nominees in Uncontested Elections

#### *Slate Ballots*

**Current Recommendation:** None. Cautionary language is included in analyses for all issuers with slate elections urging them to elect directors individually.

**Key Change:** RMG will recommend withhold on directors with slate ballots who have additional governance or compensation concerns.

**New Recommendation:** Generally WITHHOLD votes from all directors nominated by slate ballot at the annual/general or annual/special shareholders' meetings of TSX reporting issuers where RMG has identified (i) additional corporate governance practices that fall short of best practice for the Canadian market; or (ii) concerns about compensation practices and the alignment of pay with performance. This policy will not apply to contested director elections at this time.

Any one of the following board-related governance practices in addition to a slate ballot which has the effect of insulating directors from shareholder votes may result in a WITHHOLD:

- Less than majority independent board;
- Less than majority independent key committees;
- Insiders on key committees;
- Lack of separate nominating or compensation committee;
- Less than 75% director attendance without acceptable reason, or director attendance has not been disclosed;
- No disclosure of audit fees broken down by category as required by regulatory disclosure rules;
- Non-audit fees (Other fees) paid to the external audit firm exceed audit and audit-related fees;
- Former CEO/CFO on the audit or compensation committee;
- Chair/CEO role is not separated - or no independent Lead Director identified; or
- Board is classified.

The following may also be taken into consideration and contribute to a WITHHOLD from the entire slate:

- Dual Class Capital Structure (common share capital structure with unequal voting rights);
- Pay for performance disconnect;
- Poor pay practices are a concern;
- One year TSR is in the bottom half of the company's GICS group median;
- Disclosure concerns; or
- Other significant corporate governance concerns.

Compelling reasons for not applying the above policy include:

- The company was listed on the TSX Venture Exchange and recently graduated to the TSX; or
- The company has committed to replace slate director elections with individual director elections within a year.

**Rationale for Update:** A company's relationship with its shareholders and how it allows shareholders to vote for its directors are the foundation of its corporate governance structure. Some of Canada's largest issuers continue to elect directors by slate ballot, depriving shareholders of the opportunity to express approval or disapproval for individual directors. Although the number of slate ballots has declined in the last two years a minority of issuers have ignored calls from regulators and corporate governance advocates to hold meaningful director elections.

However, a significant percentage of issuers on the TSX (between 40 and 50 percent ) continue to present a slate ballot item on their proxies. Therefore, the new recommendation will have a double trigger: a slate election together with any one corporate governance concern listed in the policy will warrant a withhold vote recommendation. This double trigger addresses the fundamental concern with slate director elections: they discourage shareholders from providing feedback through director elections and they effectively shield directors from shareholder disapproval. The new policy will remove the protective shield of slate elections at companies with questionable corporate governance practices.

RMG believes that shareholders should have the ability to vote for their choice of directors individually from either ballot in a contested election so that the resulting board of directors truly reflects the wishes of a majority of the shareholders. RMG evaluates proxy contests primarily based on an assessment of the need for change, and which slate of nominees are most likely to provide the greatest shareholder value going forward. Although corporate governance practices can be a key determinant in the decision to support one side or the other, most often the decision is based on performance and qualifications. This, in addition to the ongoing challenges with the mechanics of proxy voting, particularly in the case of highly contentious proxy contests, leads us to believe that it is appropriate to carve contested elections out of this policy at this time.



### ***Voting on Directors for Egregious Actions***

**Current Recommendation:** No current formal policy.

**Key Change:** Clarify language under the election of directors policy to reflect that RMG will consider a potential adverse vote recommendation at the board, committee, or individual level, on an exceptional basis, if a director who has had significant involvement with a failed company and/or where a director has in the past appeared not to have acted in the best interests of all shareholders.

**New Recommendation:** Under extraordinary circumstances, vote AGAINST or WITHHOLD from directors individually, on a committee, or the entire board, due to:

- Material failures of governance, stewardship, or fiduciary responsibilities at the company;
- Failure to replace management as appropriate; or
- Egregious actions related to the director(s)' service on other boards that raise substantial doubt about his or her ability to effectively oversee management and serve the best interests of shareholders at any company.

**Rationale for Update:** Director accountability and competence have become issues of prime importance given the failings in oversight exposed by the global financial crisis. There is also concern over the environment in the boardrooms of certain markets, where past failures appear to be no impediment to continued or new

appointments at major companies and may not be part of the evaluation process at companies in considering whether an individual is, or continues to be, fit for the role and best able to serve shareholders' interests.

This update clarifies RMG's position that, under exceptional circumstances that raise substantial doubt on a director's ability to serve as an effective monitor of management and in the best interests of shareholders including past performance on other boards, we may consider a negative recommendation on directors.



## COMPENSATION

### Corporate Governance Issue: Advisory Vote on Executive Compensation (Say-on-Pay) Management Proposals

**Current Recommendation:** None

**Key Change:** Adopting a formal policy to use for evaluating management say- on- pay proposals in Canada.

**New Recommendation:**

Vote CASE-BY-CASE on management proposals for an advisory shareholder vote on executive compensation. Vote AGAINST these resolutions in cases where boards have failed to demonstrate good stewardship of investors' interests regarding executive compensation practices.

1. The following five global principles apply to all markets:

- **Maintain appropriate pay-for-performance alignment with emphasis on long-term shareholder value:** This principle encompasses overall executive pay practices, which must be designed to attract, retain, and appropriately motivate the key employees who drive shareholder value creation over the long term. It will take into consideration, among other factors: the linkage between pay and performance; the mix between fixed and variable pay; performance goals; and equity-based plan costs;
- **Avoid arrangements that risk “pay for failure”:** This principle addresses the use and appropriateness of long or indefinite contracts, excessive severance packages, and guaranteed compensation;
- **Maintain an independent and effective compensation committee:** This principle promotes oversight of executive pay programs by directors with appropriate skills, knowledge, experience, and a sound process for compensation decision-making (e.g., including access to independent expertise and advice when needed);
- **Provide shareholders with clear, comprehensive compensation disclosures:** This principle underscores the importance of informative and timely disclosures that enable shareholders to evaluate executive pay practices fully and fairly;
- **Avoid inappropriate pay to non-executive directors:** This principle recognizes the interests of shareholders in ensuring that compensation to outside directors does not compromise their independence and ability to make appropriate judgments in overseeing managers' pay and performance. At the market level, it may incorporate a variety of generally accepted best practices.

2. For Canadian companies, vote CASE-BY-CASE considering the factors listed below in the context of each company's specific circumstances and the board's disclosed rationale for its practices. If the company maintains poor pay for performance; problematic pay practices and/or lacks appropriate board communication and responsiveness, in general vote AGAINST Management Say on Pay (MSOP) proposals; and/or WITHHOLD on compensation committee members (or the entire board if director elections are presented as a slate ballot).

#### Pay for Performance:

- Rationale for determining compensation (e.g., why certain elements and pay targets are used, how they are used in relation to the company's business strategy, and specific incentive plan goals, especially retrospective goals) and linkage of compensation to long-term performance;
- Evaluation of peer group benchmarking used to set target pay or award opportunities;
- Analysis of company performance and executive pay trends over time, taking into account RMG's Pay for Performance policy;
- Mix of fixed (non-performance based pay) versus variable (performance-based pay).

#### Pay Practices:

- Assessment of compensation components included in RMG's Problematic Pay Practices policy such as: perks, severance packages, employee loans, supplemental executive pension plans, internal pay disparity and equity plan practices (including option backdating, repricing, option exchanges, or cancellations/surrenders and re-grants etc).;
- Existence of measures that discourage excessive risk taking which include but are not limited to: clawbacks, holdbacks, stock ownership requirements, deferred compensation practices etc.

#### Board Communications and Responsiveness:

- Clarity of disclosure (e.g. whether the company's Form 51-102F6 disclosure provides timely, accurate, clear information about compensation practices in both tabular format and narrative discussion);
- Assessment of board's responsiveness to investor concerns on compensation issues (e.g., whether the company engaged with shareholders and / or responded to majority-supported shareholder proposals relating to executive pay).

**Rationale for Update:** Although no Canadian Management Say-on-Pay (MSOP) proposals appeared on ballots in 2009, a total of thirteen public issuers have voluntarily adopted advisory votes beginning in 2010. The majority of these companies operate in the financial sector.

The recent global economic turmoil has increased public and shareholder focus on executive compensation practices, leading to higher support for say on pay shareholder proposals. Other markets that have adopted advisory votes and are comparable to the Canadian market include Australia, the U.K and the U.S. The Canadian market is similar to Australia and the U.K. in that a principles-based 'comply or explain' corporate governance best practice approach is applied and dialogue and engagement between institutional shareholders and issuers has increased in recent years. However, the close proximity of Canada to the U.S. and the economic integration of the two markets has historically led to Canadian regulators adopting similar legislation to the U.S. in areas concerning auditor independence and executive compensation disclosure. Notably, the U.S. is currently in the process of potentially legislating Management Say on Pay resolutions at every public

company. At present, shareholder proposals have been the main impetus for companies to adopt say on pay resolutions in Canada and there are no plans at present to legislate advisory votes on compensation in Canada. However, this may change once U.S. companies are mandated to adopt MSOPs.



## Corporate Governance Issue: Problematic Pay Practices

**Current Recommendation:** For TSX Composite Companies, in general, WITHHOLD from compensation committee members if the company has poor compensation practices. In general, WITHHOLD on the entire slate if individual director elections are not permitted and the company has demonstrated poor compensation practices. Also, generally vote AGAINST equity plans if the plan is a vehicle for poor compensation practices.

The following practices, while not exhaustive, are examples of poor compensation practices that may warrant a vote against or withholding votes:

- Egregious employment contracts:
  - Contracts containing multi-year guarantees for salary increases, bonuses and equity compensation;
- Excessive perks:
  - Overly generous cost and/or reimbursement of taxes for personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances, and/or other excessive arrangements relative to base salary;
  - Perquisites for former executives such as car allowance, personal use of corporate aircraft, or other inappropriate arrangements;
- Abnormally large bonus payouts without justifiable performance linkage or proper disclosure:
  - Performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance;
- Payment of dividends on performance awards:
  - Performance award grants for which dividends are paid during the period before the performance criteria or goals have been achieved, and therefore not yet earned;
- Egregious pension/SERP (supplemental executive retirement plan) payouts:
  - Inclusion of performance-based equity awards in the pension calculation;
  - Inclusion of target (unearned) or excessive bonus amounts in the pension calculation;
  - Addition of extra years service credited without compelling rationale;
  - No absolute limit on SERP annual pension benefits (any limit should ideally be expressed in \$ terms);
  - No reduction in benefits on a pro-rata basis in the case of early retirement;
- New CEO with overly generous new hire package:
  - Excessive “make whole” provisions;
  - Any of the poor pay practices listed in this policy;

- Excessive severance and/or change-in-control provisions:
  - Inclusion of excessive change-in-control or severance payments, especially those with a multiple in excess of 3X cash pay;
  - Severance paid for a “performance termination” (i.e. due to the executive’s failure to perform job functions at the appropriate level);
  - Change-in-control payouts without loss of job or substantial diminution of job duties (single-triggered);
  - New or materially amended employment or severance agreements that provide for modified single triggers, under which an executive may voluntarily leave for any reason and still receive the change-in-control severance package;
- Poor disclosure practices:
  - Generally omission of information necessary to understand the rationale for compensation setting process and outcomes, or omission of material contracts, agreements or shareholder disclosure documents;
- Internal Pay Disparity:
  - Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO);
- Employee Loans:
  - Interest free or low interest loans extended by the company to employees for the purpose of exercising options or acquiring equity to meet holding requirements or as compensation;
- Options Backdating;
- Other excessive compensation payouts or poor pay practices at the company.

**Key Changes:** Changing the definition of excessive severance payments from greater than 3Xs cash compensation to greater than 2Xs cash compensation (salary + bonus), and adding risk-mitigating pay practices section to the policy.

**New Recommendation:** For S&P/TSX Composite Index Companies, in general, vote AGAINST management advisory vote proposals, and/or WITHHOLD from compensation committee members if the company has problematic compensation practices. In general, WITHHOLD on the entire slate if individual director elections are not permitted and the company has demonstrated problematic compensation practices. Also, generally vote AGAINST equity plans if the plan is a vehicle for problematic compensation practices.

Generally vote based on the preponderance of problematic elements; however, certain adverse practices may warrant Withhold or Against votes on a stand-alone basis in particularly egregious cases. The following practices, while not exhaustive, are examples of problematic compensation practices that may warrant a vote against or withholding votes:

- Poor disclosure practices:
  - General omission of timely information necessary to understand the rationale for compensation setting process and outcomes, or omission of material contracts, agreements or shareholder disclosure documents;

- New CEO with overly generous new hire package:
  - Excessive “make whole” provisions;
  - Any of the problematic pay practices listed in this policy;
- Egregious employment contracts:
  - Contracts containing multi-year guarantees for salary increases, bonuses and equity compensation;
- Employee Loans:
  - Interest free or low interest loans extended by the company to employees for the purpose of exercising options or acquiring equity to meet holding requirements or as compensation;
- Excessive severance and/or change-in-control provisions:
  - Inclusion of excessive change-in-control or severance payments, especially those with a multiple in excess of 2X cash pay (salary + bonus);
  - Severance paid for a “performance termination” (i.e. due to the executive’s failure to perform job functions at the appropriate level);
  - Employment or severance agreements that provide for modified single triggers, under which an executive may voluntarily leave following a change of control for any reason and still receive the change-in-control severance package;
  - Perquisites for former executives such as car allowance, personal use of corporate aircraft, or other inappropriate arrangements;
  - Change-in-control payouts without loss of job or substantial diminution of job duties (single-triggered);
- Abnormally large bonus payouts without justifiable performance linkage or proper disclosure:
  - Performance metrics that are changed, canceled, or replaced during the performance period without adequate explanation of the action and the link to performance;
- Egregious pension/SERP (supplemental executive retirement plan) payouts:
  - Inclusion of performance-based equity awards in the pension calculation;
  - Inclusion of target (unearned) or excessive bonus amounts in the pension calculation;
  - Addition of extra years service credited without compelling rationale;
  - No absolute limit on SERP annual pension benefits (any limit should ideally be expressed in \$ terms);
  - No reduction in benefits on a pro-rata basis in the case of early retirement;
- Excessive perks:
  - Overly generous cost and/or reimbursement of taxes for personal use of corporate aircraft, personal security systems maintenance and/or installation, car allowances, and/or other excessive arrangements relative to base salary;
- Payment of dividends on performance awards:
  - Performance award grants for which dividends are paid during the period before the performance criteria or goals have been achieved, and therefore not yet earned;
- Problematic option granting practices:

- Backdating options, or retroactively setting a stock option's exercise price lower than the prevailing market value at the grant date;
- Springloading options, or timing the grant of options;
- Cancellation and subsequent re-grant of options;
- Internal Pay Disparity:
  - Excessive differential between CEO total pay and that of next highest-paid named executive officer (NEO);
- Absence of pay practices that discourage excessive risk taking:
  - These provisions include but are not limited to: clawbacks, holdbacks, stock ownership requirements, deferred bonus and equity award compensation practices, etc;
  - Financial institutions will be expected to have adopted or at least addressed the provisions listed above in accordance with the Financial Stability Board's (FSB) Compensation Practices and standards for financial companies;
- Other excessive compensation payouts or problematic pay practices at the company.

**Rationale for Update:** As shareholders become increasingly focused on companies' compensation practices and their alignment with a pay-for-performance philosophy, risk-adjusted pay practices and severance agreements are being more heavily scrutinized by investors. These policy updates are in line with best practice and acknowledge legislative and common law obligations relating to severance agreements.



### Corporate Governance Issue: Volatility and Stock Price Assumptions in Equity Plan Proposals (SVT)

**Current Calculation:** For the Dec. 1, 2008, Mar. 1, Jun. 1 and Sept. 1, 2009 quarterly data downloads, RMG calculated the 400-day volatility and 90-day average stock price for the shareholder value transfer policy.

**Key Change:** RMG intends to revert to the 200-day volatility and 200-day average stock price for the Dec. 1, 2009 and subsequent quarterly data downloads.

**New Calculation:** For the Dec. 1, 2009 and future quarterly data downloads, RMG will calculate the 200-day volatility and the 200-day average stock price for the shareholder value transfer policy.

**Rationale for Update:** While the stock market has experienced volatile periods in the past and may in the future, volatility levels at the end of 2008 and early 2009 were unprecedented. This extraordinary stock price volatility could have led to unintended consequences such as companies' stock option valuations moving closer to that of full value shares in some cases. By extending the 200-day volatility to 400-day volatility for the next four quarters, the spike in volatility had less impact, and thus provided better representation of companies' stock valuation. The unprecedented volatility rendered many options to be deeply-under-the-water during 2009, therefore by using a 90-day stock price RMG has minimized the measurement discrepancy in

valuing potential underwater options. As the 200-day value moves further away from the unprecedented period of market volatility in late 2008 and early 2009, the impact on stock award valuations between the 200-day and 400-day measurements has decreased. This trend is expected to continue as the market stabilizes over time.

