Trends in Corporate Governance

LAUREL HILL

2020

Trends in Corporate Governance

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Laurel Hill's expert team provides unequalled strategic solutions, shareholder results, and client satisfaction.

Trusted Annual Meeting and Year-Round Governance Partner. We work collaboratively with many of Canada's most successful companies to deliver industry-leading governance, compensation, and shareholder communications advice and execution.

#1 in Canada Proxy Contest Record. We have the best win-loss record in board-related proxy contests, at 45 wins to only nine losses, and a winning head-to-head record against all of our competitors.

#1 in Canada in Friendly & Contested M&A Mandates (2019) – for the Fourth Straight Year. We are routinely engaged on Canada's largest and most complex transactions.

#1 in Canada in Hostile Bid Mandates. Since the new takeover bid regime took effect in May 2016, we have been engaged on nearly 75% of all unsolicited takeover bid mandates, acting on 13 of the 18 hostile bids.

Letter From the President

The global pandemic, heightened social and political tensions, and turmoil in financial markets have created considerable disruption and uncertainty for corporate Canada; indeed, to levels most of us have never witnessed before. What we can be *certain* of, though, is that now more than ever, companies need to have purpose beyond maximizing returns. "Doing good" is just as important as "doing well." Good governance, acting with social purpose, and stakeholder engagement have never been as important as they are at this moment to the success of an organization. Laurel Hill has spoken about the importance of these values and actions over the years, but the events of 2020 have firmly anchored them as drivers of risk management and value creation. The reality is, if you have not already built the foundation to tackle these challenges, *the time is now.*

In this context, the Laurel Hill team has endeavoured to prepare our sixth annual *Trends in Corporate Governance Report.* This report, as always, serves to highlight trends, risks, and challenges across the governance and activism landscape. More critically, we strive to provide boards and management teams with *practical guidance and insights* to help them prepare for what lies ahead, whatever that may be, and to *help facilitate conversations* at the board, management, and stakeholder levels. Of course, each situation is unique, and we are always available to speak specifically to your company, at your convenience.

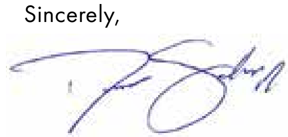
Some highlights of this 2020 report to note:

- **Shareholder Activism:** Overall, activism has dropped off this year, given the poor optics and other challenges faced by would-be activists. The headline board and transactional activism campaigns of 2019 have largely fallen away, and the number of shareholder proposals has likewise been modest. However, given Canada's propensity for activism directed at smaller targets, it is not that surprising to report we are, in fact, on pace for higher levels of board activism in the micro- and small-cap space this year – much of it has only been pushed back into the latter half of 2020. As we enter 2021, we will see a lot of dry powder activism – across all forms of activism – and companies should be prepared.
- **Environmental, Social, and Governance (ESG):** The importance of ESG has been amplified by the events of 2020. The view that ESG will only materialize in the long term is now clearly obsolete. To this point, those who have dedicated resources to ESG have been far better positioned to manage these challenges than those without ESG programs, and will almost certainly be stronger as we re-emerge. In fact, while these matters were once considered to be beyond the board scope, failure to tackle them is now viewed by many as a breach of fiduciary duty. As we review the importance of all matters ESG-related, the momentum, rationale, and benefits only continue to gain in prominence and scope.
- **Executive Compensation & Say on Pay:** In 2020, shareholders supported say-on-pay resolutions more than at any time in the past 10 years, while proxy advisors made the fewest negative recommendations since such votes were introduced to Canada in 2010. Similarly, equity compensation plans at TSX Composite companies received increased shareholder support. While this is a positive development, there is a distinct possibility that the circumstances left shareholders a little more sympathetic this time around, and next year they may not be as understanding.

As we enter our 14th year of business, Laurel Hill is very proud of our deep and experienced team of capital markets professionals and our reputation as a trusted advisor. While markets fluctuate and corporate governance continues to evolve, and even our shareholder communications and advisory industry competitors come and go, Laurel Hill's focus and mission remain unchanged: to deliver unequalled strategic solutions, shareholder results, and client satisfaction.

On behalf of the Laurel Hill team, it is my pleasure to present our sixth annual *Trends in Corporate Governance Report.* Thank you for your time and support, and for allowing us the opportunity to work with the leaders of corporate Canada. We welcome your feedback and look forward to speaking with you as you prepare for 2021.

Sincerely,



David Salmon
President

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Trends in Activism

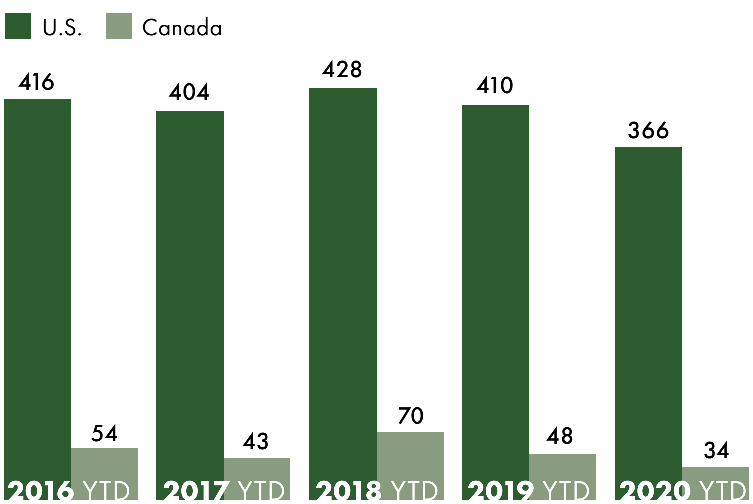
Introduction

COVID-19's devastating impacts on the global financial markets have, of course, not left shareholder activism unscathed. Not surprisingly, the optics of activist interventions have been poor, particularly in the early months of the pandemic. Boards and management teams have all been in survival mode, focused on running their businesses, ensuring employee health and safety, and preserving cash in the event it is required to weather a long-term downturn. Demands for increased dividends and share buybacks have largely been off the table, while demands for asset sales and M&A transactions would be easier to dismiss at this year's "fire-sale" valuations. Furthermore, with many M&A deals delayed or called off, there have simply been fewer opportunities for "bumpitrage," by which dissidents attempt to profit by pushing for improved deal prices or superior transactions.

Activists have also faced other obstacles: They rely on the support of other shareholders – in particular institutional shareholders. Contact between activists and shareholders has continued, to some degree, through virtual engagement. However, their preferred face-to-face contact, through which they can better share ideas and gauge support, has simply not been possible. Regulators and stock exchanges have allowed companies to delay annual meetings beyond their normal timeframes. Mailing and postal delays have caused the proxy solicitation window to become narrowed or missed entirely, particularly for retail support. Finally, activists are generally wary of virtual meetings, which have become increasingly necessary this year, as there is less transparency regarding meeting conduct, and less ability to engage with the board, management, and other shareholders, when compared to an in-person meeting.

While many activists clearly withdrew or paused campaigns this year, they have not been sitting idle. In fact, some have been positioning themselves for future disruption. U.S.-based activist funds and private equity firms in particular have large pools of capital; the drop in stock prices and new equity offerings have created buying opportunities at would-be targets, creating larger toeholds for future campaigns and M&A activity.

Number of Companies Publicly Subjected to Activist Demands Across the U.S. and Canada



Source: Activist Insight, January 1 to September 27 each year.

"Now it's reached a point that there are some companies that are just sort of given away."

– Carl Icahn on CNBC, March 13, 2020

Activists are also closely monitoring how companies perform through the pandemic relative to their peers, as a barometer of board and management effectiveness. Ultimately, the crisis will help activists further identify underperforming and inadequate teams, and reveal strategic and operational weaknesses, making cases for change even more compelling.

Shareholder activism in Canada in 2020 has followed these broad trend lines, but only to a certain point. In 2019, we saw a record high number of large Canadian companies become the targets of board activism. We also saw unprecedented levels of transactional activism. On both fronts, 2020 has been a relatively quiet year. The number of shareholder proposals is also down this year. On the other hand, we have, in fact, seen an increased number of board fights at smaller companies; if anything, it seems the pandemic has only delayed some of these campaigns beyond the "normal" proxy season to the latter half of the year. The reality is that a significant amount of Canada's activism is being driven by first-time and homegrown "concerned shareholders," including company founders and former insiders. These dissidents generally focus their efforts on smaller companies. So, while "professional" activists – who tend to favour larger targets – may have been concerned that "poor optics" would damage their reputations and ability to attract future capital, many of our dissidents have charged ahead, albeit with a primary focus on board activism.

Starting this fall, we have begun to witness indications of a resurgence of 2019's headline board and transactional activism dynamics. As the economy continues to recover, and M&A activity returns, the stage is set for a robust 2021 for shareholder activism. We discuss these Canadian board and transactional activism dynamics, as well as developments in shareholder proposals, unsolicited offers and short-selling activism, in this 2020 report.

"… we are buying stocks. These are bargains of a lifetime if we manage this crisis correctly."

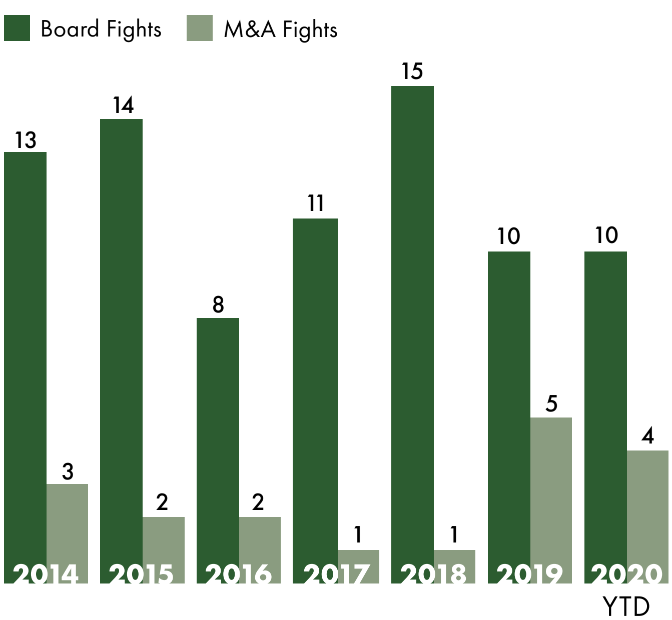
– Bill Ackman on Twitter, March 18, 2020

Board Activism

In spite of the overall decrease in activism noted above, the number of board-related proxy fights in Canada this year is already on par with the total for all of 2019. Furthermore, if three additional current activist situations meet our criteria for a "proxy fight," we will reach 13 board fights. However, as we noted in the "Introduction" and explain in more detail below, board activism this year has been dominated by campaigns at micro- and small-cap companies, while board activism at mid- and large-cap targets – which experienced a significant uptick in 2019 – has dropped off this year.

There have been four M&A fights this year, down from five last year. Consistent with 2019 trending, there is crossover between board and transactional activism. The dissident in the board fight at Artis Real Estate Investment Trust is also waging an M&A fight against Artis' proposed spin-off of its retail portfolio. The board fight at Australis Capital follows on the dissidents' successful M&A fight, where the group's public broadcast solicitation in opposition to a proposed acquisition led to the termination of the acquisition. In addition, there was a board fight and concurrent M&A fight at GMP Capital, and the board situation at Dealnet Capital also involves opposition to a friendly takeover bid. We discuss these cases and another M&A fight in more detail in our "Transactional Activism" section.

Board and M&A Proxy Fights



Source: Filings on www.sedar.com up to October 5, 2020, subject to our criteria (see "What is considered a 'proxy fight'?").

What is considered a "proxy fight"? Laurel Hill defines a proxy fight as an activism situation that involves the actual *solicitation* of shareholders by a dissident, either by filing of an information circular or by press release disclosing the use of the National Instrument 51-102 public broadcast exemption. We specifically exclude cases that are settled or withdrawn prior to any such solicitation. In other words, we define a proxy fight as a situation where the dissident actively campaigns for shareholder support. However, we do also include the rare cases where dissident nominees are included in a management's circular and there is otherwise no dissident solicitation. We use the meeting date to determine the year of the proxy fight, except that if the proxy fight is settled or withdrawn prior to the meeting date, we use the date of the settlement or withdrawal.

The timing of many of these board fights has certainly been unusual, but not surprising. Given the regulatory bodies' and stock exchanges' permissions to delay meetings beyond the normal timeframes, target companies have had greater flexibility to postpone meeting dates in response to activism. We have seen numerous examples of companies postponing previously scheduled meetings until later in the year, citing the inability of virtual meeting providers to support contested meetings. In "normal" times, almost all proxy fights would be in the books by this time of year. This year, five of the 10 proxy fight outcomes are still outstanding, and we may yet have three more fights on our hands.

Board Proxy Fights in 2020 (targets in alphabetical order)

Target	Industry	Cap	Dissident(s)	Dissident Solicitation	Dissident Proxy	Management Proxy	Outcome
Artis Real Estate Investment Trust	Real Estate	Large	Sandpiper Group	Public Broadcast	TBD	TBD	TBD
Aurwest Resources Corporation	Mining	Micro	Colin Christensen, Elmer B. Stewart, Warren Brown, Cameron MacDonald	Circular	Standard	Standard	Dissident Full Win
Australis Capital Inc.	Industrials	Micro	Roger Sykes, 1703469 Alberta Ltd.; Duke Fu, Green Therapeutics LLC; Jason Dyck; Terry Booth, Lola Ventures Inc.	Public Broadcast	TBD	TBD	TBD
GMP Capital Inc.	Financial Services	Small	Kevin Sullivan	Circular	Universal	Standard	Management Win
Happy Creek Minerals Ltd.	Mining	Micro	White Tiger Venture Group Ltd.	Public Broadcast	None	Standard	Management Win
Karnalyte Resources Inc.	Mining	Micro	Mark Zachanowich, Peter Mason, Greg Szabo	Circular	TBD	TBD	TBD
Knighthawk Inc.	Industrials	Micro	Bruce Mitchell	None	None	Standard[1]	TBD
MGX Minerals Inc.	Mining	Micro	Lance Arneson, David Simmons	Public Broadcast	TBD	TBD	TBD
Optiva Inc.	Technology	Small	Maple Rock Capital Partners, Inc.	Public Broadcast	n/a	n/a	Dissident Full Win
Turquoise Hill Resources Ltd.	Mining	Large	Pentwater Capital Management LP	Circular	Universal	Universal	Management Win

Source: Filings on www.sedar.com up to October 5, 2020.

As noted above, there are three other developing board situations this year that may yet meet our criteria for a proxy fight, namely at Cascadero Copper Corporation, Dealnet Capital Corp., and Deeprock Minerals Inc.

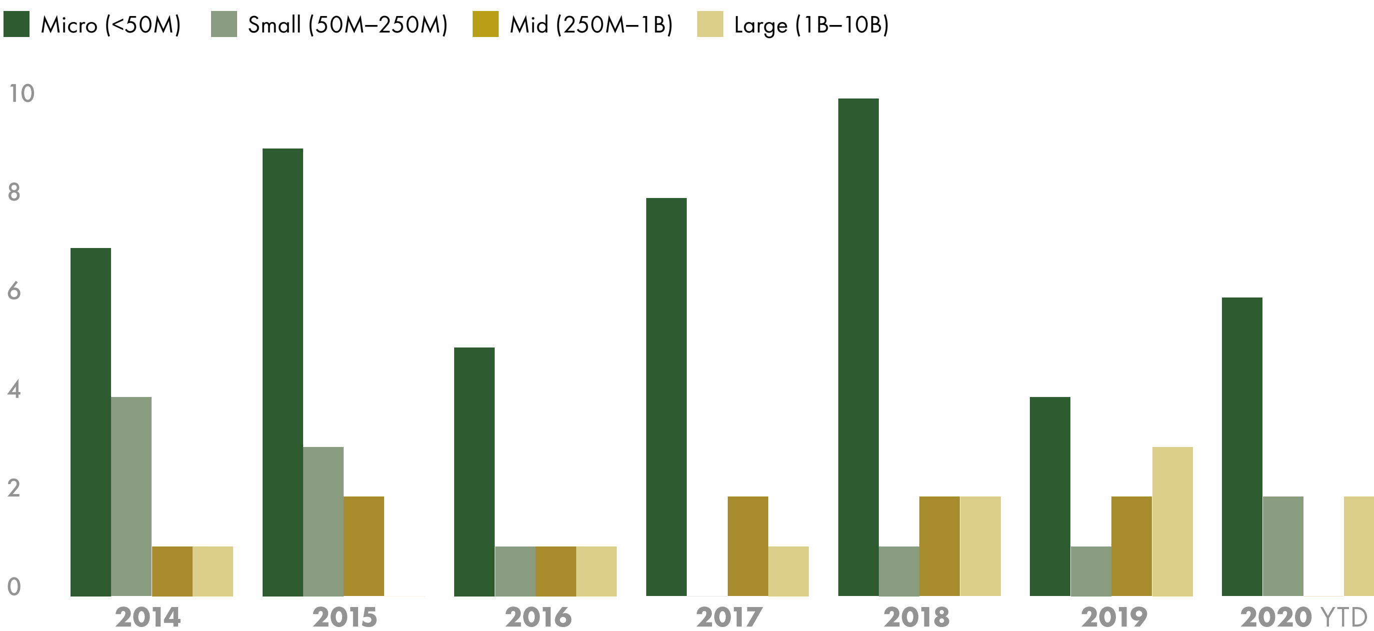
In addition, we point out other board situations that did not meet our criteria for a proxy fight, namely also at Cascadero (by a different dissident than at the developing Cascadero situation noted above), Copper North Mining Corp., Decisive Dividend Corp. (which involved an unsuccessful "ambush" at the company's annual meeting), and Just Energy Group Inc.

[1] The management circular contained only dissident nominees (as set out in the dissident's requisition). The dissident has not undertaken any separate public broadcast or circular solicitation and has not issued its own proxy.

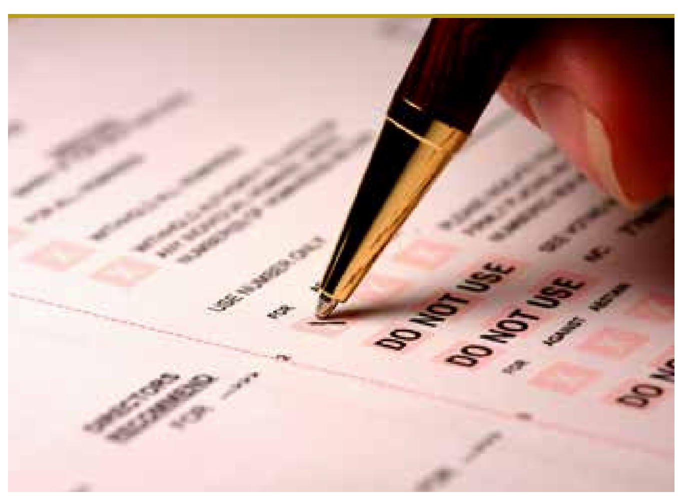
Target Capitalizations

Historically, most proxy fights have been in the micro- and small-cap space, which aligns with the fact that the majority of Canada's public companies are listed on venture exchanges such as the TSXV, rather than the TSX. In 2019, we started to see an increasing number of fights at mid- and large-caps, representing 50% of all fights, likely spurred on by the late-2018 activist board fight win at large-cap Detour Gold Corporation, and the concessions to the terms of the early-2019 mega-cap merger between Goldcorp Inc. and Newmont Mining Corporation obtained through activist interventions. In 2020, however, mid- and large-cap targets have dropped off, representing only 20% of fights, with micro- and small-caps accounting for 80% of fights.

Board Proxy Fights by Market Capitalization



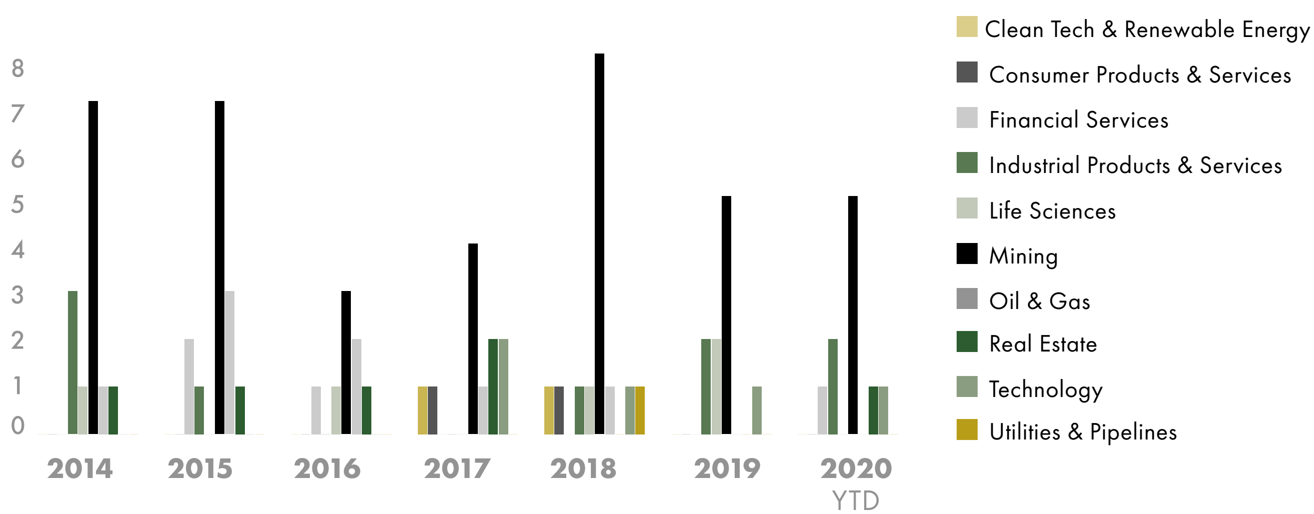
We believe that this year's drop in fights at the larger companies will be short-lived. The activist hedge funds, private equity firms, and other sophisticated investors who pursue these targets, and who have shown restraint this year, will likely start to renew their efforts into 2021. Many of these players have used the market downturn to increase their ownership stakes in would-be targets. Now, they will be building up even more compelling cases for change through their analyses of how boards and management teams have performed during the pandemic relative to their peers.



Target Industries

Targets in the mining sector have, once again, dominated board proxy fights this year, representing 50% of all fights, unchanged from 2019. We note, however, that mining stocks represent about 50% of all TSX and TSXV issuers (excluding CEFs, CPCs, SPACs, and ETFs), and so mining targets are, in fact, proportionally represented this year. In other industries, we have again seen fights at industrial products and services companies and at technology companies in 2020, similar to 2019. A target in financial services has emerged this year while there was none in 2019, and targets in life sciences have fallen off as compared to last year. For the first time since 2017, we have seen a target in real estate.

Board Proxy Fights by Target Industry

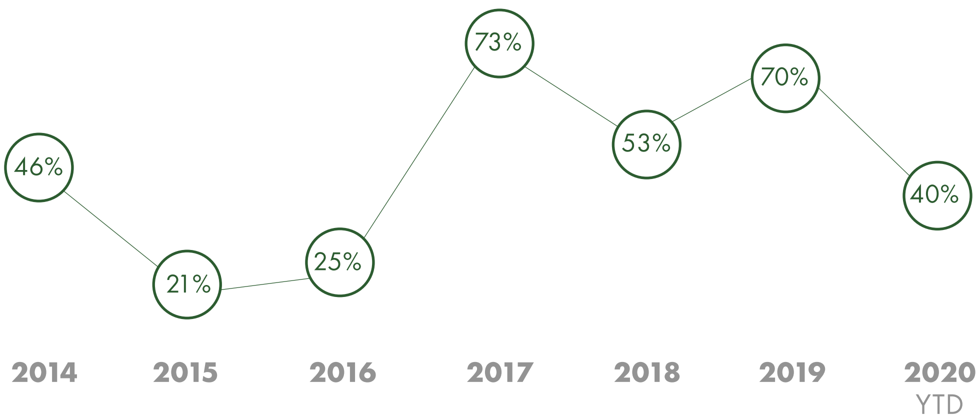


The reality is that, over the years, we have seen targets in virtually every sector, so no industry should consider itself immune from activism. We had anticipated more activism in the cannabis space, and the industry has now seen its first board fight (which follows an M&A fight). Technically recorded as an Industrials company (per its profile on the CSE), Australis Capital – a 2018 spin-off of cannabis industry heavyweight Aurora Cannabis Inc. – according to its website, "looks to acquire and operates U.S. cannabis businesses and brands."

Dissident Win Rates

The dissident win rate has been somewhat erratic from year to year. Nevertheless, dissidents continue to see strong levels of proxy fight success, achieving some or all of their publicly stated objectives; and this has happened in at least 40% of fights in each of the past four years, up from only 21% in 2015. As we explain below, several factors support the trending in favour of dissident success. As we like to remind our management clients, dissidents start a proxy fight expecting to win – and recently the numbers have been on their side.

Board Proxy Fight Dissident Win Rates



What is a considered a "dissident win"? Laurel Hill defines a dissident win as an outcome where the dissident achieves some (a "partial win") or all (a "full win") of its publicly stated objectives, either through a settlement in advance of the meeting or through the vote at the meeting.

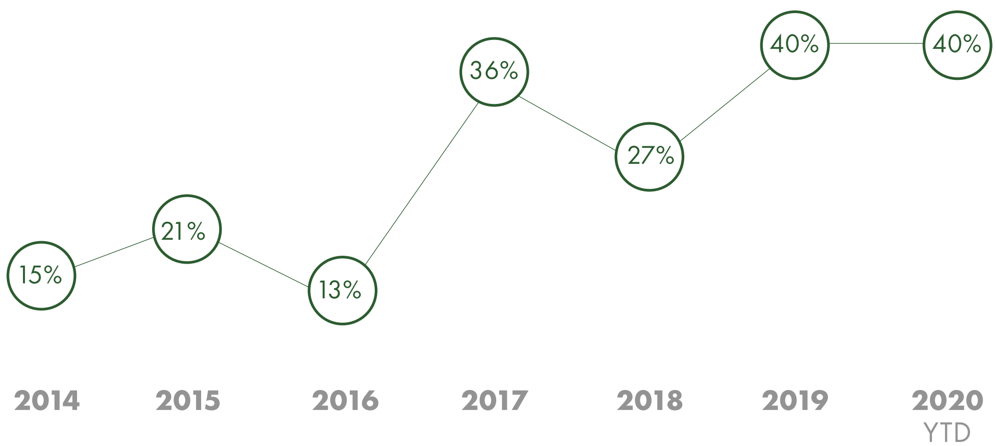
Management enjoys certain important "home-court" advantages over dissidents, including a general shareholder propensity to give management the benefit of the doubt, control over the selection of meeting and record dates and over meeting mechanics and, importantly, access to corporate funds to potentially outspend and outlast dissidents.

We attribute the trending in favour of dissident success to several factors: First, at the micro- and small-cap level, which represents the clear majority of all proxy fights, the barriers to entry and success are relatively low. The targets often have limited resources, weak governance and shareholder engagement, and low voter turnout. Furthermore, concerned shareholders with significant ownership stakes – including company founders and former insiders, putting themselves in a relative position of strength – often undertake these fights. Then at the mid- and large-cap level, although occurring less frequently, the activist funds, private equity firms, and other large investors that tend to drive these fights are generally sophisticated, prepared, and deep-pocketed. In addition, in recent years, activist funds have gained more credibility and they now often benefit from the support of institutional shareholders and proxy advisory firms.

Settlement Rates

This year, we have added settlement rates for board proxy fights to our report metrics. It is not uncommon for both sides to want to arrive at a settlement to avoid the costs, distractions, and reputational risks of a full-blown fight. Similar to dissident win rates, settlement rates have noticeably increased in the past four years; in fact, dissident "partial wins" frequently come through settlements. More broadly, the longer-term trending clearly indicates a greater propensity to settle, although this still occurs in a clear minority of cases.

Board Proxy Fight Settlement Rates



What is a considered a "settlement"? Laurel Hill defines a settlement as an outcome whereby management announces a settlement (regardless of which side it may favour, if any) with the dissident after a proxy fight has commenced and prior to the meeting date (if set).

Universal Proxy

This March, the U.S. Securities and Exchange Commission (SEC) signalled that it is likely to move forward with the adoption of a universal proxy rule in contested director elections, further to a rule first proposed in 2016. According to SEC Commissioner Elad L. Roisman, "There seems to be growing consensus that a universal proxy rule could provide benefits to everyone involved in a proxy contest, most importantly, the investors being solicited."[2] Ontario's Capital Markets Modernization Taskforce (which we touch on more broadly in our "Trends in Governance" section), in its July 2020 consultation report, also proposed the adoption of a universal proxy in contested elections.

A universal proxy, in which both management and dissident nominees are listed, has until recently rarely been used in either the U.S. or Canada. In the U.S., unlike in Canada, the consent of the opposing side is required prior to listing that side's nominees, except in the case of "short slates," and such consent is rare. In Canada through 2019, management had used a universal proxy in only three cases, while dissidents had used one in 15 cases (including opposite the three management cases).[3] In 2020, management has so far used a universal proxy only once, while dissidents have used one twice (including opposite the one management case).

For shareholders, a universal proxy is ideal, as they can vote for their preferred combination of nominees, rather than being limited to voting for only dissident or management nominees on their respective proxies. This is of even greater importance when a proxy advisory firm issues a "split" voting recommendation, which has become increasingly frequent, as we noted in our 2019 report. Furthermore, the universal proxy would replicate the in-person voting experience where the ballot contains both sets of nominees. There is no doubt this would enhance shareholder rights and reduce shareholder confusion. In fact, the universal proxy is considered a governance best practice by the Canadian Coalition for Good Governance.

[2] Speech at the Council of Institutional Investors' (CII) Conference, https://www.sec.gov/news/speech/speech-roisman-cii-2020-03-10.

[3] Number of cases as reported in Davies Ward Phillips & Vineberg LLP "Governance Insights 2019," https://www.dwpv.com/en/insights/publications/2019/davies-governance-insights-2019.

It is important to note that there are reasons dissidents have used a universal proxy more than management have (by a ratio of about 4:1). For dissidents, the shareholder rights and good governance angles are often central to their campaigns against an incumbent board, and so a universal proxy is an appealing option. In addition, dissidents who put forward a short slate, or who may not realistically expect all of their nominees to be elected, are more likely to use a universal proxy. For management, however, a universal proxy provides enhanced exposure and credibility to the dissident campaign and its nominees, and effectively signals to shareholders that the dissident nominees are "good enough" to be on the management proxy. Furthermore, if split votes result in a board consisting of both management and dissident nominees, the mixed board may not have the appropriate balance of skills, experience, and diversity that the company has in many cases worked hard to achieve.

WHAT YOU NEED TO KNOW:

The reality is that, in Canada, the number of board contests not settled prior to the issuance of proxies is relatively low. So, at least in the short term, a universal proxy is not likely to be of the highest priority for regulators in Canada. However, given the U.S. move towards adoption and Ontario's Capital Markets Modernization Taskforce proposal, there appears to be a push towards universal proxy use in Canada. Issuers should be aware that a universal proxy often strategically favours dissidents over management, and so its mandatory adoption may tip outcomes in dissidents' favour.

Majority Voting

Shareholders seeking to effect board change typically put forward their own board nominees. However, TSX-mandated majority voting requirements represent another way for shareholders to voice their concerns by withholding on individual nominees. If the "withhold" votes outnumber the "for" votes, such nominees, if they are incumbent directors, are forced to submit their resignations. In 2019, eight director nominees at five different companies received less-than-majority support. In all but one case, at Baylin Technologies Inc., the "failed" nominees resigned. This year, there has been only one failed nominee case, at Dynacor Gold Mines Inc., and there has not yet been any public disclosure of that nominee's resignation.[4]

In the 2019 Baylin Technologies case, the nominee, David Gelerman, refused to resign and applied to the Ontario Superior Court of Justice for an order to allow him to complete his term. The Court ruled in Gelerman's favour. Hansell McLaughlin Advisory Group recently wrote about the ruling:[5]

> *"The Court found that Baylin's majority voting policy had been drafted in order to enable the removal of Mr. Gelerman as a director without violating the terms of the sale agreement. The Court found that the policy did not in fact align with the TSX requirements and that the advice to the board regarding the policy had been false and misleading. The Court held that the policy was oppressive and unfairly prejudicial and unfairly disregarded both Gelerman's and Spacebridge's [the company subject to the sale agreement, for which Gelerman had been the CEO] reasonable expectations, specifically in Gelerman remaining a director for the period of the earn-out. The Baylin case addresses a long held concern among some that majority voting policies can be abused. The Ontario Superior Court's decision validates that concern and provides guidance for issuers, directors and investors on the appropriate use of majority voting policies."*

There has been no indication, as of yet, whether or not the pending *Canada Business Corporations Act* (CBCA) majority voting requirement will be in effect for the 2021 proxy season. This requirement will also be applicable to CBCA venture issuers who are not currently required to have a majority voting policy. In anticipation of this new rule, CBCA venture issuers should think carefully about how their director candidates may hold up under shareholder "withhold" votes, and perhaps even under "vote withhold" public campaigns, and manage their

[4] 2019 and 2020 failed nominee numbers per filings on www.sedar.com, January 1 to September 18 each year.

[5] Hansell McLaughlin Advisory Group, "Majority Voting Policy Found to be Oppressive, Considerations for Director Elections During COVID-19," https://www.hanselladvisory.com/publication/majority-voting-policy-found-to-be-oppressive.

director nominations accordingly. We note that this year, 16 directors received majority votes, but less than 60% support.[6] Most of these directors serve at energy companies, one of the hardest-hit industries this year. Similar to when there is weak support for say-on-pay resolutions, proxy advisors and shareholders alike will expect some kind of response in next year's circular in respect of what the company has done to address shareholder concerns in this area.

Transactional Activism

The pandemic has had a severe impact on Canadian M&A activity during 2020, which was poised to be a record year. As reported in a recent Torys LLP article[7]:

> *"At the beginning of the year, the business outlook in Canada was optimistic – both in terms of domestic and global activity. 2019 had been a banner year for M&A in Canada, with megadeals driving up total deal value which reached a ten-year high of $102 billion. Robust equity markets, low interest rates, healthy consumer spending and historically high levels of dry powder in the private equity sector were all expected to drive strong dealmaking in 2020. When the pandemic hit, many companies shifted to survival mode with M&A taking a back seat; sales processes were paused or in some cases cancelled outright, resulting in a significant decrease in activity. There have also been a number of high-profile broken deals with transactions being litigated before the courts in Canada and the United States."*

In this context, it is not surprising that we have seen a significant drop in transactional activism this year, following a breakout 2019 for this type of activism, but it has certainly not disappeared either. Transactional activism takes many forms, including demands for strategic reviews, divestitures, share buybacks, and increased dividends; and opposition to board-supported plans of arrangement. As we discussed in the "Introduction," many of these demands have simply been unworkable in this environment, and there have clearly been fewer opportunities to oppose friendly deals and profit from "bumpitrage."

Notable Transactional Activism in 2020 (companies in alphabetical order)

Company/Deal	Industry	Cap	Activist(s)	M&A Fight	Description/Outcome
Artis Real Estate Investment Trust/Proposed spin-off of retail portfolio	Real Estate	Large	Sandpiper Group, FC Private Equity Realty Management Corp.	Yes	Public Broadcast solicitations against the spin-off. Outcome TBD.
Australis Capital Inc./ Proposed acquisition of Passport Technologies Inc.	Industrials	Micro	Roger Sykes, 1703469 Alberta Ltd., Duke Fu, Green Therapeutics LLC	Yes	Public Broadcast solicitation against the acquisition; led to termination of the deal. A board fight is ongoing. Outcome TBD.
BlackBerry Limited/ Proposed recapitalization transactions	Technology	Large	Dorsey R. Gardner	No	Press release opposition to transactions that would give Fairfax Financial Holdings Limited a control position; demanded shareholder vote. The company amended the terms to limit Fairfax participation in order to avoid shareholder vote.

[6] Per filings on www.sedar.com, up to September 18, 2020.

[7] Torys LLP, "Will a 'Canada First' sentiment curb M&A?," https://www.torys.com/insights/publications/2020/07/will-a-canada-first-sentiment-curb-m-a.

Company/Deal	Industry	Cap	Activist(s)	M&A Fight	Description/Outcome
Calfrac Well Services Ltd./ Proposed recapitalization transaction	Oil & Gas	Micro	Wilks Brothers, LLC	Yes	Proxy circular solicitation against the management transaction, while it proposed its own alternative transaction and launched an unsolicited offer to incentivize shareholders to vote against the management transaction. Outcome TBD.
Cineplex Inc./Proposed arrangement with Cineworld Group, plc	Communications & Media	Large (now Mid)	Bluebell Partners	No	Letter sent to Canadian government opposing the arrangement. Separately, Cineworld terminated the arrangement, citing breaches by Cineplex of the arrangement and that a material adverse effect had occurred. Cineplex commenced a court action for damages for what it claims is a wrongful repudiation of the arrangement.
Dealnet Capital Corp./ Friendly offer by Simply Green Home Services Inc.	Financial Services	Micro	Capital Partners Corporation/Steven Small, Municipal Home Service Inc.	No	Press release opposition to offer encouraging shareholders to not tender. Had earlier requisitioned meeting, and company set date, but company delayed meeting to later in 2020 upon announcement of the offer.
GMP Capital Inc. (GMP)/ Proposed acquisition of Richardson GMP Limited (RGMP)	Financial Services	Small	Kevin Sullivan, Anson Funds	Yes	Proxy circular solicitation by Sullivan against acquisition, together with proposed board nominees. Pursuant to settlement, GMP and RGMP agreed to revise acquisition to return additional cash to shareholders through a substantial issuer bid, and Sullivan board nominees withdrew.
iAnthus Capital Holdings, Inc./Proposed recapitalization transaction	Life Sciences	Micro	Unknown	No	Social media opposition to transaction. Approved by shareholders, remains subject to court approval.
Teck Resources Limited	Mining	Mega	Tribeca Investment Partners, Impala Asset Management	No	Reportedly urged company to divest its energy and coal businesses, replace CEO, and eliminate dual-class share structure.
Torstar Corporation/ Proposed arrangement with NordStar Capital LP	Communications & Media	Small	Canadian Modern Media Holdings Inc.	No	Proposed competing bid for Torstar and undertook court challenge. Torstar successfully closed arrangement. See "The Competing Bid for Torstar" below.

Source: Filings on www.sedar.com and other public sources up to October 5, 2020.

Recapitalization transactions have been a notable source of activism this year. Specifically, they include the M&A fight at Calfrac Well Services Ltd. in opposition to its recapitalization transaction (which also involves a hostile bid for the company, as we discuss in our "Unsolicited Offers" section); the informal social media campaign against the iAnthus Capital Holdings, Inc. recapitalization transaction; and a shareholder publicly opposing BlackBerry Limited's recapitalization transactions.

The recurring theme across many of these opposition campaigns involves charges around unfair and conflicted processes and, more specifically, the integrity of these processes at the board and special committee levels. These issues were central in the opposition to the insider-led deal at Hudson's Bay Company late last year and in the competing bid for Torstar this year, as we discuss in detail below.

The M&A Fight at HBC

In our 2019 report, we discussed Catalyst Capital Group Inc.'s successful use of a mini-tender offer to acquire additional shares of Hudson's Bay Company (HBC). Catalyst was attempting to block the proposed privatization of HBC by a 57% group of HBC shareholders, including the company's governor and executive chairman, and other insiders (Baker Group), at $9.45 per share. Following our report, the story continued to develop and ultimately proved to be one of the most interesting and successful examples of transactional activism in 2019.

While HBC agreed to a privatization with the Baker Group, at an increased price of $10.30 per share, Catalyst announced that it and other shareholders, representing 28% of HBC's outstanding shares – a majority of the minority shares, more than enough to defeat the vote – still opposed the deal and intended to vote against its approval. Catalyst announced that it had proposed to HBC to acquire the company for $11.00 per share, while at the same time it sought regulatory intervention of the privatization at the Ontario Securities Commission (OSC) and solicited votes against the deal:

> *"The Insider Issuer Bid is the result of a deeply flawed process. The Insider Issuer Bid, and the negotiations among the Baker Group leading up to the making of that proposal, could only have been made based on material information that was not generally disclosed. The proposal and related negotiations thus likely involved breaches of management and director fiduciary duties and related duties of confidence. In addition, the Baker Group was formed with the goal of seeking to negate key aspects of the mandate of the Special Committee, including the consideration of any alternative transactions available to the Company, and otherwise acted in a coercive manner to undermine the Special Committee. If this type of transaction and conduct is condoned, it would serve to undermine confidence in the fairness and integrity of the capital markets overall. Catalyst implores the OSC to examine the Insider Issuer Bid and take appropriate action."*[8]

In response, HBC's special committee stated that the Baker Group communicated it was not interested in selling its shares, and therefore the Catalyst offer, which would require the approval of at least two-thirds of all shareholders, was not reasonably capable of being consummated. It concluded that the Catalyst offer could therefore not be deemed a "Superior Proposal" to the privatization agreement.

Of interest, the two major proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis, came out with split recommendations on the privatization vote. ISS recommended shareholders vote against the insider deal, citing flaws with respect to the sale process, while Glass Lewis endorsed the transaction, noting it was at that point the only viable path forward given the rejection of the Catalyst proposal.

Following an OSC hearing, the OSC required that HBC delay its special meeting to approve the privatization, and that it revise its management information circular to disclose additional information on the background to the transaction and the board and special committee approval process. The parties, with the support of Catalyst, subsequently agreed to increase the privatization price to $11.00 – a 16% increase to the originally proposed price of $9.45.

[8] Catalyst Capital Group Inc., Press Release, November 27, 2019.

The Competing Bid for Torstar

In February, Torstar Corporation received an unsolicited offer from NordStar Capital LP to take the company private at $0.566 per share. Following a robust special committee process, which included the canvassing of 26 alternative potential buyers, the company eventually signed an arrangement agreement with NordStar at $0.63 per share. The arrangement also executed "soft" lock-ups with the five families that have controlled the company for 60 years (through a Voting Trust) and Hamblin Watsa Investment Counsel Inc. (HWIC), an affiliate of Fairfax Financial Holdings Ltd., collectively representing 61% of the company's outstanding shares.

Canadian Modern Media Holdings Inc. (CMMH) attempted to outbid NordStar with a bid of $0.72, which it later increased to $0.72 plus a contingent value right (CVR). In response, NordStar agreed to increase its all-cash bid to $0.74, subject to the execution of new "hard" lock-ups with the 61% shareholders. By the time that CMMH came back with an improved all-cash bid of $0.80, the new hard lock-ups had been signed. The board determined that CMMH's revised bid could therefore not constitute a "Superior Proposal" under the arrangement, because it was not reasonably capable of being completed. At the shareholder meeting, shareholders voted 98.7% in favour of the NordStar transaction, and a final court order approving the deal was issued.

CMMH filed a motion with the Ontario Superior Court of Justice for a stay of the final court order pending appeal. In the judge's written Reasons,[9] CMMH argued, "(a) the Board's alleged failure to consider the Appellants' proposal; (b) the Board's alleged acquiescence in the hard lock up agreements; and (c) the Board's alleged failure of disclosure to the shareholders." The Court dismissed these arguments and the motion. The arrangement was completed and CMMH withdrew its appeal. In the Reasons, the judge commented that the board was reasonable in its determination that the $0.80 CMMH bid was not a Superior Proposal:

> *"The Voting Trust and HWIC were not ... prepared to support the CMMH proposal. It is easy to see why. CMMH's proposal was unsolicited. CMMH was a new entrant to this process and unknown. Neither Torstar nor its majority shareholders were aware of CMMH's financial capacity to consummate any transaction. Its proposal was conditional on due diligence and the negotiation of a definitive agreement. The Board, the Voting Trust and HWIC had just taken over three months to negotiate the Arrangement Agreement with NordStar. The CMMH proposal was not a "cash only" offer. It is clear that the Board, the Voting Trust and HWIC were only interested in an all cash offer. The fact that CMMH thought that the CVR was worth something is largely irrelevant. The Board, the Voting Trust and HWIC did not share CMMHs optimistic viewpoint, as was their right. A bird in the hand, as the saying goes, is worth two in the bush.*
>
> *With the Voting Trust and HWCI's refusal to support the CMMH proposal and subsequent agreement to sign hard lock up agreements to vote in favour of the NordStar proposal, the Board reasonably determined, with the benefit of its outside legal counsel and financial advisors, that the CMMH proposal was not reasonably capable of being completed without undue delay relative to the Arrangement, taking into account all financial, legal, regulatory and other aspects of the proposal."*

WHAT YOU NEED TO KNOW:

Minority shareholders are increasingly likely to challenge material conflict-of-interest transactions where there may be questions around the integrity of the process and the adequacy of disclosure. The OSC decision in the HBC case reaffirms important guidance contained in the Canadian Securities Administrators' (CSA) *Staff Notice 61-302 Staff Review and Commentary on Multilateral Instrument 61-101, Protection of Minority Security Holders in Special Transactions* in respect of expectations of special committees and standards of disclosure. Specifically, the Commission will scrutinize (i) the timing of formation and the mandate of the special committee, (ii) the robustness and independence of the special committee's process, including the hiring of independent legal and financial advisors, and (iii) the adequacy of disclosure to minority shareholders related to that process. The Torstar case reinforces the importance of the integrity of the process and disclosure. In addition, while it is always a good practice to seek and obtain soft lock-ups with key shareholders, the execution of hard lock-ups with shareholders who are unquestionably satisfied with the "bird in the hand" is an astute strategic move.

[9] "CITATION: Re Torstar Corporation and Nordstar Capital LP, 2020 ONSC 4679 DIVISIONAL COURT FILE NO.: CVD-TOR-43-20AP DATE: 20200804," https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/knowledge-pdfs/torstar-stay-reasons-signed.pdf?revision=1aa01d2f-7112-45cf-ac01-5f8d02a42224.

The Shareholders' Gold Council and Activism in the Gold Sector

In September, the Shareholders' Gold Council (SGC), a coalition of prominent mining investors, released an open letter[10] to the global gold industry. The letter has 24 signatories, including the SGC, as well as 11 of the SGC's 13 disclosed members, CI Investments, Franklin Templeton, Mackenzie Investments, Sprott, and VanEck, among others.

The gold sector and its investors have enjoyed soaring stock prices this year, with the TSX Global Gold Index up by more than 40%, driven by record-high gold bullion prices (resulting from pandemic-induced market anxiety). In spite of this industry success, the letter's signatories expressed concerns that gold companies are nevertheless falling short in the areas of corporate governance, executive compensation alignment, strategic vision, and shareholder engagement, and made 16 specific suggestions for improvement. The letter states that changes are necessary to attract more generalist investors to the sector, in order to lower the cost of capital:

> *"Despite the strong performance of precious metals mining equities in 2020, investor flows into active and passive fund strategies have been lackluster. In contrast, flows into physical metals and related ETFs have been record breaking. The contrast suggests that the appeal of mining equities remains limited to specialist funds and has escaped the attention of generalist investors. Despite strong performance, mining shares are still episodically inexpensive. We believe that adoption of these suggested measures will improve current low equity valuations by attracting a wider audience of generalist investors and thereby lower the industry's cost of capital to the benefit of all stakeholders."*

The SGC, started by Paulson & Co. Inc. in 2018, has previously issued two reports against the gold sector, which we discussed in detail in our 2019 report. The first one criticized low levels of board and management stock ownership and called on the industry to increase alignment of interests. The second one criticized G&A mismanagement and called on companies to explore ways to reduce excessive spending levels. Last year, the SGC targeted what it called "gratuitous" and "outrageous" compensation at Goldcorp Inc., including in connection with its merger with Newmont, and called for increased consolidation in the sector to rid the "industry of poor stewards of shareholder capital."[11] That effort followed Paulson & Co.'s 2018 board fight win at Detour Gold Corporation.

WHAT YOU NEED TO KNOW:

Many of the most prominent investors in the gold sector are increasingly demanding improvements in corporate governance, using the term in its broadest sense. Companies that do not pay attention to these demands are exposing themselves to a greater likelihood of shareholder activism through board challenges, opposition to M&A transactions, and other public criticisms; and they risk losing access to capital in favour of peers who are more responsive. Issuers outside of the gold sector should take note of these efforts, and address any of their own deficiencies in these areas, as shareholder campaigns and successes here will undoubtedly influence shareholder behaviour in other sectors.

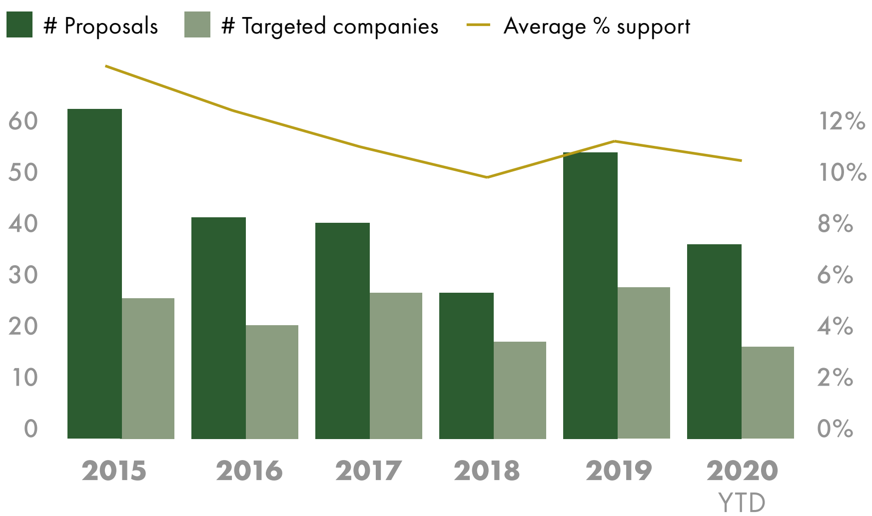
[10] Shareholders' Gold Council, "Open Letter to Global Gold Company CEOs and Boards," https://www.goldcouncil.net/press-release.

[11] Shareholders' Gold Council, "Shareholders' Gold Council Condemns Goldcorp's Board of Directors," https://www.goldcouncil.net/press-release.

Shareholder Proposals

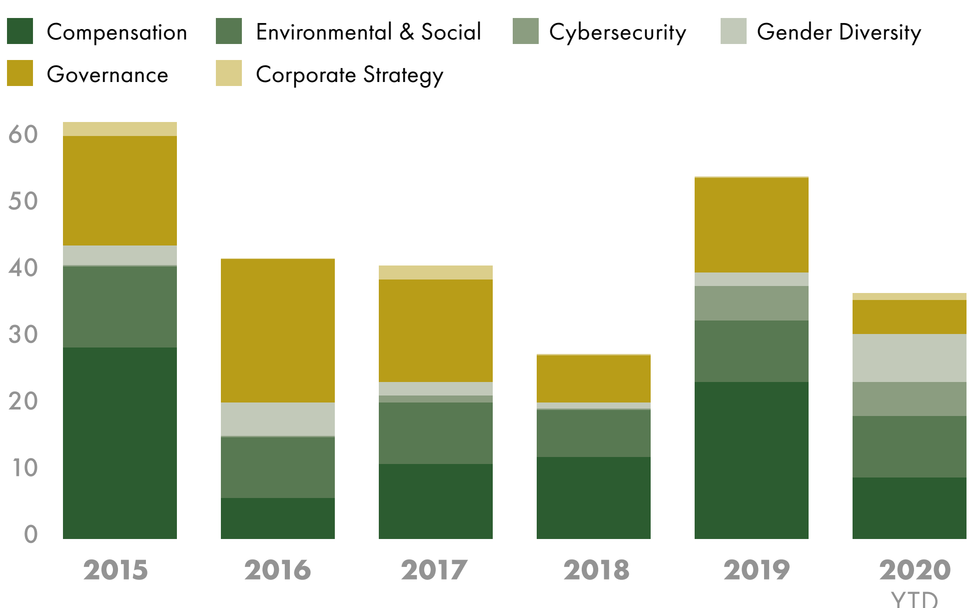
This year, the number of shareholder proposals has dropped by about 52%, from 53 in 2019 to 36 in 2020. The number of individual targeted companies also fell by about 28%, from 28 in 2019 to 17[12] in 2020. It is notable, however, that the 36 proposals this year remain 33% above the 27 proposals in 2018. Furthermore, while the average support level decreased modestly this year, from 11.6% in 2019 to 10.9% in 2020, it remains above the 10.3% of 2018. Proposals related to compensation, environmental and social matters, gender diversity, and cybersecurity have been front and centre this year.

Shareholder Proposal Key Metrics



Source: Compiled from ISS Corporate Solutions data, for proposals submitted to a vote at meetings held January 1 to June 30 each year. Average percentage support levels exclude any proposals supported by management.

Shareholder Proposals by Category



Source: Compiled from ISS Corporate Solutions data, for proposals submitted to a vote at meetings held January 1 to June 30 each year.

[12] We note the 2019 targeted companies that avoided proposals in 2020 were not as a result of shareholder meeting dates having been delayed beyond June 30 (as a result of COVID-19).

- **Compensation:** Although still prominent, the largest category decrease in proposals this year came in the form of compensation proposals, which dropped from 23 in 2019 to nine in 2020. While in the past we have seen an uptick in proposals to adopt a say-on-pay vote, the reality is that an increasing number of companies have voluntarily adopted one, and *Canada Business Corporations Act* (CBCA) issuers will soon be forced to adopt one. Therefore, it is not surprising to have seen a drop in compensation proposals this year. In addition, 2019 proposals to disclose the CEO-to-median-employee-compensation ratio and to incorporate ESG metrics into compensation decisions – neither of which garnered much traction – largely dropped off this year.
- **Environmental & Social:** The number of E&S proposals has remained steady this year, and the split between E&S proposals is also the same year over year. In 2020, five proposals related to environmental risk oversight, policies, and disclosure; and four proposals related to human rights risk and human capital management oversight, policies, and disclosure. We note that the only two proposals to have passed this year (without management support) were on environmental matters.
- **Gender Diversity:** The most significant category increase in proposals this year came in the form of gender diversity proposals. Specifically, all seven of this year's proposals were to set gender diversity at the board level at 40%. However, neither of the two 2019 proposals to adopt a gender diversity policy were repeated this year.
- **Cybersecurity:** This is an area that many boards have been paying increasing attention to in recent years; therefore, we are not surprised to have seen the emergence of these types of proposals in the past two years. In particular, four proposals this year related to providing disclosure around investments in technology, for both competitive and cybersecurity reasons. The five 2019 proposals to create new board technologies committees, also for both competitive and cybersecurity reasons, dropped to just one this year.
- **Governance:** The volume of other governance proposals fell this year, from 14 in 2019 to five in 2020. Most notably, none of the five 2019 proposals to disclose how director independence is determined reappeared this year. In most years, a few governance proposals will relate to eliminating dual-class voting structures or providing separate disclosure of voting results by class, and there were three such proposals this year. Notably, while not the object of a shareholder proposal this year, Alimentation Couche Tard Inc.'s dual-class voting structure will terminate next year on the day that all four of its co-founders will have reached the age of 65.

In September, the U.S. Securities and Exchange Commission (SEC) voted to adopt amendments to modernize its shareholder proposal rule,[13] which will make it more difficult for shareholders and shareholder proponents to submit and resubmit shareholder proposals. The amended rule will take effect in 2022, with a one-year transitional period with respect to the new ownership thresholds. The most significant changes include:

- raising the current ownership thresholds of $2,000 or 1% of securities for at least one year with three alternative thresholds: $2,000 of securities for at least three years, $15,000 of securities for at least two years, or $25,000 of securities for at least one year;
- "applying the one-proposal rule to 'each person' rather than 'each shareholder' who submits a proposal, such that a shareholder-proponent will not be permitted to submit one proposal in his or her own name and simultaneously serve as a representative to submit a different proposal on another shareholder's behalf for consideration at the same meeting. Likewise, a representative will not be permitted to submit more than one proposal to be considered at the same meeting, even if the representative were to submit each proposal on behalf of different shareholders."; and
- "revising the levels of shareholder support a proposal must receive to be eligible for resubmission at the same company's future shareholder meetings from 3%, 6% and 10% for matters previously voted on once, twice or three or more times in the last five years, respectively, with thresholds of 5%, 15% and 25%, respectively."

In Canada, where shareholder proposals are governed by federal and provincial corporate statutes, there are similarities with the existing SEC rule. For example, the CBCA also provides a $2,000 or 1% ownership requirement (except that for director nominations, it is 5%), and a resubmission requirement based on support minimums of 3%, 6% and 10%. There has not, however, been any groundswell of support to similarly make it more difficult to submit and resubmit proposals here. Having said that, Ontario's Capital Markets Modernization Taskforce, in its July 2020 consultation report, submitted a proposal to, "Empower the OSC to provide its views to an issuer with respect to the exclusion by an issuer of shareholder proposals in the issuer's proxy materials (no-action letter)," similar to the SEC's "no-action letter" process.

WHAT YOU NEED TO KNOW:

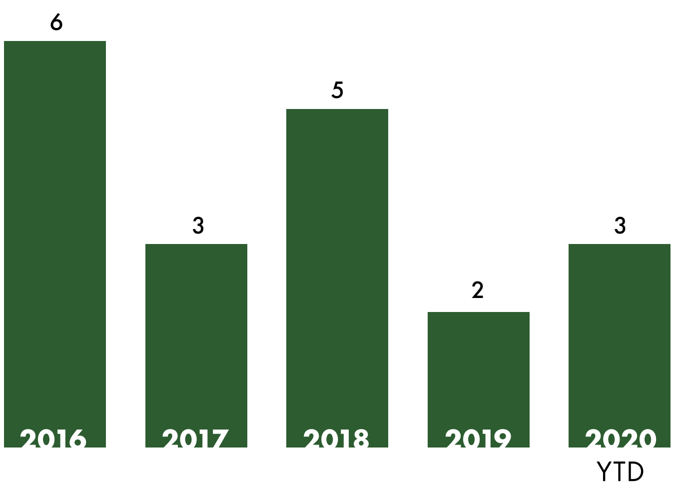
Shareholder proposals continue to be an important form of shareholder activism. Over the years, many shareholder proposals have ultimately become industry best practices, such as those to have a separate chair and CEO, to phase out stock options, and to adopt say-on-pay votes. In particular, at companies with dual-class structures, a majority shareholder, or a dominant minority shareholder, we often still see the same proposals, year after year, and with incremental levels of support each time. Despite the mathematical impossibility of approval, these proposals serve as an effort to draw attention and wear down company resistance. Although average approval levels remain modest, we caution our clients to take proposals seriously, work constructively with proponents to try to keep proposals out of the proxy circular, and speak with their key shareholders to understand their views on specific proposals.

[13] U.S. Securities and Exchange Commission, "SEC Adopts Amendments to Modernize Shareholder Proposal Rule," https://www.sec.gov/news/press-release/2020-220.

Unsolicited Offers

We are now into the fifth year since the "new" May 2016 National Instrument 62-104 takeover bid rules took effect. These new rules increased the minimum bid period from 35 to 105 days (this may be shortened to 35 in certain circumstances) and include a "majority of the minority"[14] tender requirement, among other things. The thought process in undertaking an unsolicited offer, often referred to as a "hostile bid," has fundamentally changed. While in the past, would-be strategic and financial buyers may have launched a "first-mover" hostile bid to put targets "in play," a hostile bid is now undertaken almost only by strategic buyers, rather than by financial buyers, and almost only as a last resort, including the 2020 examples discussed below. At a certain point, a hostile bid still provides buyers the option to take their offer directly to shareholders. It can also be used to exert pressure on a target to engage in a friendly transaction, or as we have seen this year in the hostile bid for Calfrac Well Services Ltd., it can be employed to support another goal. For the same reasons, each year we see a number of examples of potential bidders making public statements of an intention to launch a bid.

Hostile Bids 2016–2020



Source: Filings on www.sedar.com, up to October 5, 2020.

From an average of 14 hostile bids per year over the 10 years ending 2014,[15] we have seen an average of only 3.8 hostile bids per year since 2016. There should be no doubt of the cooling-off effect of the new bid rules.

The three hostile bids this year, and the proposed bid for Optiva Inc. discussed below, have clearly been undertaken for the reasons described above: In June, Solgold plc (through a wholly owned subsidiary) launched a hostile bid for Cornerstone Capital Resources Inc., but only following failed negotiations dating back to 2017 to simplify the ownership structure of a mutually owned project. In September, Wilks Brothers, LLC (through a wholly owned subsidiary) launched a hostile bid for Calfrac, with an offer of a significant premium to the recovery offered under Calfrac's proposed recapitalization transaction, in order to reinforce a shareholder vote against that transaction. Also in September, Obsidian Energy Ltd. formally launched an unsolicited offer for Bonterra Energy Corp., following fruitless merger discussions between the two companies dating back to January 2019, and following Obsidian's August announcement of a proposed merger with Bonterra.

[14] This requirement specifies that an offeror may not acquire any shares under the offer unless a majority of shares, other than shares owned by the offeror or its affiliates, are tendered to the offer.

[15] Fasken Martineau DuMoulin LLP, "2015 Canadian Hostile Take-Over Bid Study," https://www.fasken.com/en/knowledge/2015/02/anextensiveempiricalstudyof-20150219/.

One of the most interesting hostile bid developments this year was the attempt by ESW Capital, LLC, the largest holder of subordinate voting shares (SVS) of Optiva, to obtain an Ontario Securities Commission (OSC) exemption from the majority of the minority requirement as a pre-condition to launching a hostile bid for the SVS of the company. Here is the background:

- ESW Capital had been the company's sole holder of preferred shares, which contractually gave it four of seven board seats, with the remaining three "independent" board seats filled by nominees of the holders of the SVS. As we note in our "Board Activism" section, Maple Rock Capital Partners Inc., the company's second-largest holder of SVS, started a board proxy fight this year over those three seats, charging that two of the three directors, in fact, had ties to ESW, and so were not truly independent.
- Maple Rock appears to have won the company over: Optiva conducted a debt financing, funded almost exclusively by Maple Rock and EdgePoint Investment Group Inc., the company's third-largest holder of SVS, and used the proceeds to redeem the preferred shares. Maple Rock and Optiva settled the proxy fight, and by the conclusion of the company's annual meeting a few weeks later, Optiva had reconstituted its board with eight seats – four of which were held by Maple Rock and EdgePoint nominees, three of which were held by new independent nominees, and only one of which was held by an incumbent ESW nominee.
- Following closing of the financing, ESW announced its proposed hostile bid, but first had to go through the OSC for an exemption from the majority-of-the-minority requirement, given that Maple Rock and EdgePoint – which had indicated it would not tender – had enough combined shares to block satisfaction of the requirement. Following hearings, however, the OSC dismissed the application.

This was the second time the OSC had ruled on the new takeover bid rules. In 2018, we wrote about Canada's first hostile takeover bid in the cannabis space,[16] which involved hearings before the Financial and Consumer Affairs Authority of Saskatchewan and the OSC. In that case, the two regulators made several important rulings related to the new takeover bid rules, in connection with a tactical shareholder rights plan, "jointly or in concert" status, the 5% open market purchase exemption, and the 105-day minimum bid period. In all instances, they ruled against tactics and defences that conflicted with or attempted to short-cut the new rules. They commented that, in the future, parties should expect that the letter and the spirit of the rules will continue to be upheld, absent extenuating circumstances. Given the OSC ruling in Optiva, the regulators appear intent on holding firm that parties will need to clear a high bar to convince regulators to allow certain tactics and defences if they contradict the letter or the spirit of the new rules.

WHAT YOU NEED TO KNOW:

Hostile bids continue to have a place in our markets, despite the material cooling-off effect with the new takeover bid regime. Where potential acquirers cannot strike a deal with targets, or for other strategic considerations, a hostile bid remains a viable option, and companies must take that possibility seriously and be prepared. Additionally, the regulators have signalled in two cases that bidders and targets must stay within the letter and the spirit of the new rules. Going into 2021, we may start to see an uptick in hostile bids, as companies who weather the pandemic – and perhaps even come out stronger – may attempt to strong-arm their way into acquiring weakened competitors, if the parties are unable to come to terms. There are already signals of this in the oil and gas sector. Stay tuned.

[16] Laurel Hill Advisory Group, "Aurora-CanniMed & The Hip: Laurel Hill's Case Study in Canada's First Hostile Cannabis Takeover," https://www.laurelhill.ca/case-studies-2.

Short-Selling Activism

Short-selling activists – primarily U.S.-based and including Citron Research, Marc Cohodes, Hindenburg Research, J Capital Research, Muddy Waters, and Spruce Point Capital – continue to make incursions into the Canadian market; although, after the six-year high of 22 Canadian campaigns reported by Activist Insight for 2018, we have observed only a handful of campaigns in each of 2019 and so far in 2020. To close out 2019, Spruce Point Capital targeted Canadian Tire Corporation, Limited. This year, Hindenburg Research has targeted Facedrive Inc.; J Capital Research has targeted NovaGold Resources Inc. and Northern Dynasty Minerals Ltd.; and Spruce Point Capital has set its sights on GFL Environmental Inc.

COVID-19 has undoubtedly played a role in dampening 2020 campaigns, as the case for an inflated valuation may have disappeared. However, as we noted in our report last year that there is reason to believe the 2019 decline in activity will be short-lived, and as markets continue to rebound this year and into 2021, activist campaigns will likely follow suit. In addition, the business disruptions caused by COVID-19 may expose more companies with questionable strategies, practices, or financials, creating more potential targets for activist short sellers.

According to a November 2019 bulletin by McMillan LLP,[17] Canadian companies have been disproportionately targeted by short-selling activists, relative to the size of our capital markets, in comparison to other countries. The bulletin notes that several factors make Canada a "Haven for Short Campaigners": First, the practice of "naked" short selling – where a short seller does not first borrow shares prior to executing a short sale – is legal in Canada, unlike in the U.S. and many other jurisdictions. Naked shorting reduces the cost of capital for short sellers (as they can avoid share borrowing costs), and means they are not constrained by the availability of shares to be borrowed. Second, regulators have historically taken a hands-off approach to enforcement of "short and distort" campaigns. Finally, there are no civil remedies in Canada for target companies and their shareholders to recover their losses from such campaigns.

While short and distort campaigns – that is, campaigns involving abusive tactics and language and which make false or misleading claims, particularly those that are published under pseudonyms – are clearly abusive and should be punished, practitioners of properly researched campaigns argue their value and importance to the capital markets. In a December 2019 special report to the *Financial Post*,[18] Ben Axler of Spruce Point Capital noted:

> *"Long-term share price declines are common among Canadian companies on which we've published and are almost always consequences of excessive market optimism and problems which we correctly identify in our reports coming to fruition. Our track record in Canada speaks to the quality of our research. We don't produce "hatchet jobs" or conduct "heists" to make a "quick profit," .... We issue deeply researched reports detailing our concerns and take risk-based investment positions on the belief that our analysis is accurate.*
>
> *Our critical research fills an important niche and serves an important role in keeping markets efficient – particularly on the short side, where such intensive research is relatively scarce."*

[17] McMillan LLP, "Short Selling in Canada: Regulations are Weak and a New Path Forward is Needed to Reduce Systemic Risk," https://www.mcmillan.ca/Short-Selling-in-Canada-Regulations-are-Weak-and-a-New-Path-Forward-is-Needed-to-Reduce.

[18] *Financial Post*, "Counterpoint: Short sellers like us create real value for public markets by telling Canadian investors the truth," https://financialpost.com/opinion/counterpoint-short-sellers-like-us-create-real-value-for-public-markets-by-telling-canadian-investors-the-truth.

There are undeniable benefits to short selling in terms of providing price discovery and liquidity. However, policies and regulations that prohibit and punish short and distort campaigns must clearly be adopted. Furthermore, certain other short-selling practices in connection with financings are also problematic. Ontario's Capital Markets Modernization Taskforce, in its July 2020 consultation report, submitted a proposal that seeks to limit a trading strategy used to finance high-risk companies, notably in the cannabis industry. The report explains:

> *"Since prospectus offerings are generally priced at a discount to the market price, market participants and investors who expect to purchase under the offering may seek to profit through aggressive short selling prior to the offering to depress the price of the offering. Short selling is particularly problematic where the underwriters are engaged in market stabilization in connection with the prospectus offering.*
>
> *Stakeholders have noted to the Taskforce that bought deals pre-arranged with hedge funds that are shorting the stock before the bought deal is announced are rife in the Canadian markets and particularly targeting capital intensive industries. This harms the corporation, its shareholders and the uninformed investors trading against the short sellers."*

WHAT YOU NEED TO KNOW:

Over the past year, industry participants have drawn new and increased attention to certain predatory and unfair short-selling practices. In its 2019–2022 Business Plan, the Canadian Securities Administrators identified the study of abusive short selling as one of its key priorities and efforts. While the regulators have historically taken a hands-off approach to short selling, with this new attention and focus on certain abuses, action will hopefully soon follow. For companies that are the target of a short attack, we continue to caution against knee-jerk responses, in particular through social media platforms. Instead, issuers must carefully consider the form and substance of their response based on the impact on the share price, the reputation and track record of the activist, and the nature and materiality of the claims being made. If a response is necessary, engagement with analysts, media, shareholders, and the short sellers themselves should be considered.

Trends in Governance

Environmental, Social, and Governance

In the past few years, environmental, social, and governance (ESG) has continued to accelerate, and its importance has been amplified in 2020 due to COVID-19. This year, we have seen a number of developments in ESG reporting, including: the shift of capital into sustainability-focused investments; the strengthening of sustainable finance; the introduction of green bonds and debt into the market; the trading of sustainable indices on the TSX; and growing support for the main reporting frameworks, namely the Task Force on Climate-related Financial Disclosures (TCFD), Sustainability Accounting Standards Board (SASB), and Global Reporting Initiative (GRI).

It is generally accepted that strong ESG disclosure and reporting is a strong indicator for a company's overall approach to managing risk, leadership, and trust. A company that has well accounted for and mitigated ESG risks will perform stronger over the long term, and is better positioned to weather disruptions than competitors that fall short in this area. However, since investors can be more focused on short-term results, translating the benefit of strong ESG performance into value has often been challenging – that is, until 2020.

The pandemic, and its effects on the economies of the world, has been dramatic and disruptive and, ultimately, has emphasized the need for companies to effectively manage risk, human capital, sustainability, and business continuity. If investors were questioning the value of ESG before COVID-19, they can now look to evidence that shows ESG-focused funds performed better than non-ESG-focused funds through this year's economic downturn. According to the Responsible Investment Association (RIA), 83% of responsible investment funds outperformed the average asset class in the first quarter of 2020. **The evidence is clear: ESG leads to better risk management, which leads to better financial and operational performance.**[19]

In addition to addressing issues like supply chain security, cybersecurity, and overall business continuity, issuers were forced to confront social issues. Companies that had a framework in place were more nimble, and better able to adapt to the circumstances and uphold stakeholder expectations.

As we come to the end of 2020, COVID-19 is better understood and, as the world reopens, companies and governments will continue to shift into the financial recovery phase. The focus on addressing the interests of ***stake***holders versus ***share***holders is more inclusive and gaining support. The pandemic, Black Lives Matter, and Indigenous movements have put a spotlight on social and systemic inequalities and elevated the social agenda; they propelled a more holistic look at ESG, including topics like workplace safety, job security, diversity, and social equity.

As a proof point, Edelman's recent *Trust Barometer* noted that 91% of Canadian institutional investors surveyed believe that maximizing returns for shareholders can no longer be a corporation's only goal.[20] In the same study, 67% of those investors choose to invest more in companies that are excelling against ESG metrics. In this context, the United Nations Principles for Responsible Investment (PRI) is looking at how financial systems should function to ensure sustainable outcomes, and asks investors to maintain a long-term focus on decision making that supports *"sustainable companies through this crisis – in the interests of public health and long-term economic performance – even if that limits short-term returns."*[21]

In the event managing risk, creating trust, measuring leadership performance, and maximizing returns is not enough of a reason to develop ESG, issuers may consider the impact on your company's share price and access to capital. According to RIA, inflows into ESG-focused ETFs in the first quarter of 2020 were $740 million, versus $142 million in 2019.[22] PRI measured the biggest increase in assets under management and the number of signatories in 2020. As signatories, these investors are committed to requiring companies to provide disclosure aligned with TCFD.

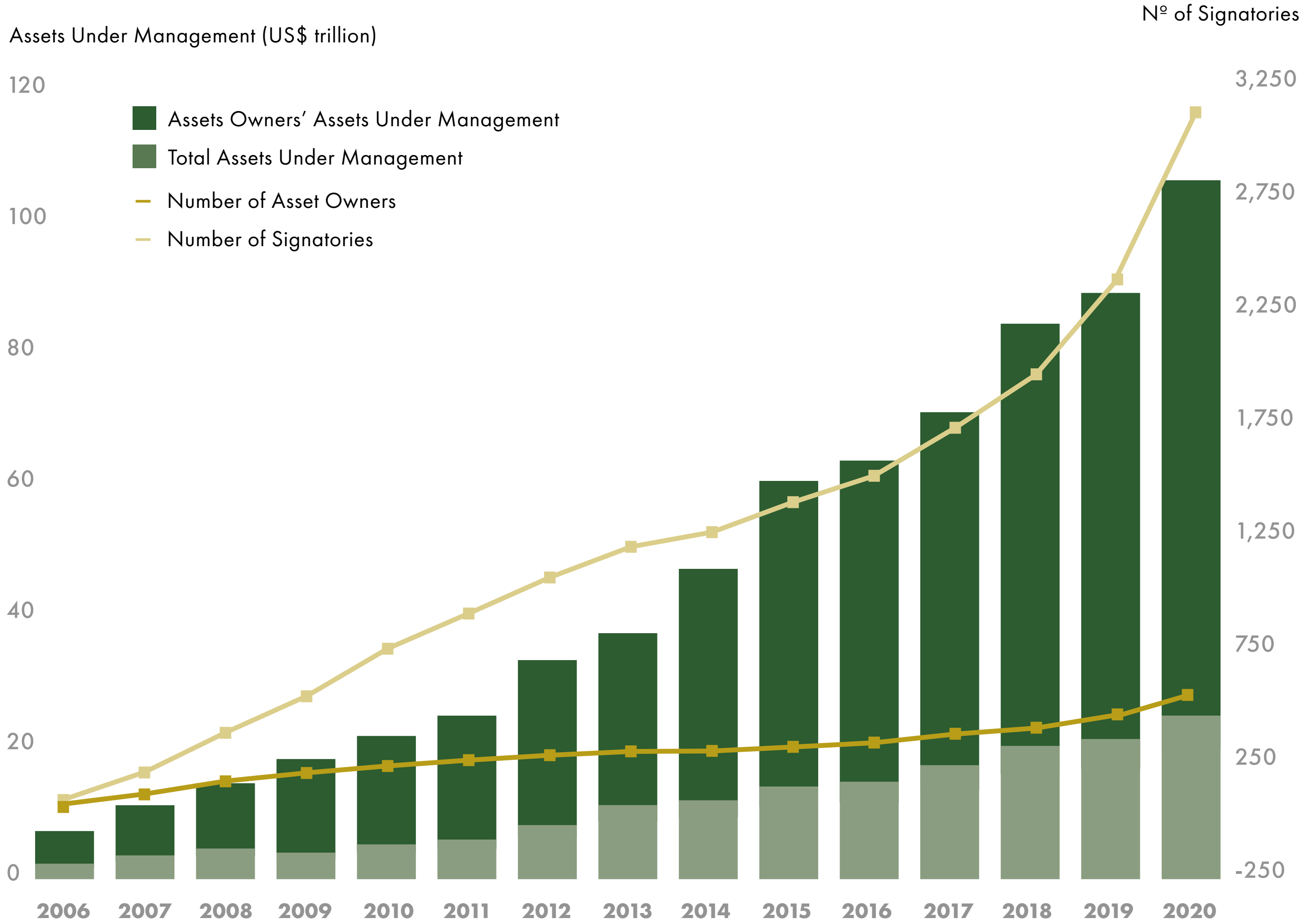
[19] RIA, "ESG and COVID-19: Four Market Trends," https://www.riacanada.ca/magazine/esg-and-covid-19-four-market-trends/.

[20] Edelman, "2020 Edelman Trust Barometer," https://www.edelman.com/trustbarometer.

[21] UNPRI, "How Responsible Investors Should Respond to the COVID-19 coronavirus crisis," https://www.unpri.org/covid-19-resources/how-responsible-investors-should-respond-to-the-covid-19-coronavirus-crisis/5627.article.

[22] RIA,"ESG and COVID-19: Four Market Trends," https://www.riacanada.ca/magazine/esg-and-covid-19-four-market-trends/.

PRI Growth 2006–2020



Source: Principles for Responsible Investing.

Furthermore, stepping up to meet the needs of investors that are increasingly evaluating companies through an ESG lens, the TSX launched six new ESG indices this summer. The indices are based on the S&P/TSX Composite and S&P/TSX 60, and will include constituents of the underlying index that also meet the ESG criteria of the index. Additionally, the TSX has plans to launch ETFs and derivatives throughout 2020 and early into 2021 to track the new indices.[23]

This ESG momentum, from an investor's view, is even impacting some hedge funds – which have typically focused on driving share value through board and management change. Recently, several funds have moved away from this traditional form of activism and refocused on sustainability. The managers of these funds have recognized that ESG performance is tied to operational and financial performance, and they are capitalizing on the opportunity to lever that performance edge and drive value from companies that manage ESG well. According to Deloitte, hedge funds that adopt impact investing – investing with purpose to generate positive social and environmental impact – will have a competitive advantage that will enable them to attract new clients and deepen relationships with existing clients.[24]

[23] TMX, "TSX to Roll Out Indices Based on S&P/TSX Composite Index and S&P/TSX 60 Index," https://www.tsx.com/tsx-company-services/learning-academy?id=399.

[24] Deloitte, "Impact Investing and Hedge Funds," https://www2.deloitte.com/us/en/pages/financial-services/articles/impact-investments-hedge-funds-esg-business.html.

ESG in the Boardroom

Investors are placing increasing pressure on boards to oversee ESG risks. Especially so with climate change being recognized by world scientists and leaders as an immediate existential threat to the world, and the understanding that key ESG elements are critical to the success of a company. Indeed, understanding material risks to a business has always been considered a fiduciary duty of the board; but formalizing ESG information within TCFD, SASB, and GRI, and framing the required disclosure as material, decision-useful information has firmly anchored ESG within the scope of board responsibilities.

In its 2020 letter to board members, State Street Global Advisors declared its intense focus on financially material ESG issues. It has rolled out its own trademarked evaluation system, R-Factor, and said, "Beginning this proxy season, we will take appropriate voting action against board members at companies in the S&P 500, FTSE 350, ASX 100, TOPIX 100, DAX 30, and CAC 40 indices that are laggards based on their R-Factor scores and that cannot articulate how they plan to improve their score. Beginning in 2022, we will expand our voting action to include those companies who have been consistently underperforming their peers on their R-Factor scores for multiple years, unless we see meaningful change."[25]

ESG oversight has become a mainstream boardroom issue; but what isn't necessarily clear is how boards should approach this.

A recent study by the non-for-profit sustainability group Ceres found that the main barriers boards face when considering ESG are (i) a misunderstanding of how ESG links to business risks, (ii) a misconception that these risks are long term and don't affect current business, and (iii) a lack of understanding of how the board can or should oversee ESG. Ultimately, each issuer should customize its own approach for what is best suited to the individual company and its industry. There is no single right way for a board to structure ESG oversight.[26]

What is important, is that boards get started and demonstrate progress on the ESG topics that are key to their financial and operational performance. State Street suggests the following steps:

- Start with understanding how the rating bodies rank your company relative to your peers;
- Use the frameworks of TCFD, SASB, and GRI to understand the issues that are material to your business and important to stakeholders;
- Determine how to integrate ESG into board activities including policies, committee structure, and charters;
- Determine which issues you are disclosing and what plan and structure you have in place to disclose additional information in the future; and
- Consider your goals and metrics, their links to executive compensation, and the shareholder engagement loop.[27]

Increasingly, shareholders are withholding on directors who are not perceived to be doing enough and are supporting more ESG proposals. We will see pressure grow on directors to demonstrate they are doing the right things with respect to ESG.

WHAT YOU NEED TO KNOW:

To meet the expectations of institutional investors, there are four key areas that boards can consider in their approach to ESG:

First, boards are expected to oversee ESG risk. It is clear, investors want to see the board and leadership as part of the solution.

Second, engage with key stakeholders. This will assist with the understanding of what is important and enable your board and executive to have a better overview and, ultimately, implementation.

Third, demonstrate progress on relevant ESG topics. We have seen firsthand how those that have undertaken this step have benefited during 2020, and how stakeholders will provide the benefit of the doubt if you continue to press forward.

Finally, disclosure. Tell your story. Investors are seeking enhanced disclosure and more consistent reporting on ESG factors. To this point, if the information is not coming from you as the source, investors will locate it elsewhere and it may not be accurate.

[25] State Street Global Advisors, "State Street Global Advisors, Letter to Board Members," https://www.ssga.com/library-content/pdfs/insights/CEOs-letter-on-SSGA-2020-proxy-voting-agenda.pdf.

[26] Ceres, "Turning Point: Corporate Progress on the Roadmap for Sustainability," https://www.ceres.org/resources/roadmap-for-sustainability.

[27] State Street Global Advisors, "Demystifying ESG for Board Members," https://www.ssga.com/us/en/intermediary/ic/insights/esg-oversight-framework-for-directors.

The ESG Landscape

Generally, there are four types of third-party organizations that participate in ESG reporting: (i) those that publish guidance with frameworks and standards, such as TCFD, SASB, and GRI; (ii) those that request information from issuers through questionnaires, such as the Carbon Disclosure Project (CDP) and on behalf of Dow Jones Sustainability Indices; (iii) those that aggregate data from company public disclosure, such as Bloomberg and Refinitiv; and (iv) those that develop corporate assessments, such as MSCI and Sustainalytics.

A July 2020 survey by SASB found that 81% of investors now recommend issuers use SASB and 77% recommend using TCFD, which also has the support of the Canadian Coalition for Good Governance and PRI, to guide their disclosure. TCFD is focused on addressing the governance and management of climate-related financial disclosure, while SASB is focused on the needs of investors and financially material topics. Social and governance topics are covered by GRI, which has complementary guidance and standards for reporting ESG topics to address the needs of a broader stakeholder base including employees, communities, and Indigenous peoples, among others. Currently, GRI and SASB are collaborating on standards and implementation guidance, and the TCFD framework is the one most often referenced in SASB implementation guidelines.[28]

- TCFD, established by investors in late 2015, provides 11 recommendations under four categories:
    1. The organizations' governance on climate-related risks and opportunities.
    2. The actual and potential climate-related opportunities and risks to the business' operations and strategy, when material.
    3. The organizations' approach to climate-related risk management.
    4. The metrics and targets used to assess climate-related risks, when material.
- SASB, established in 2011 by a number of large investors, is a guide for issuers in providing material, decision-useful disclosures regarding their financial and operating performances that most directly affect their ability to create long-term value. SASB is evidence based, industry specific, and market driven, and aims to help issuers and investors better communicate sustainability data. Its Materiality Map outlines relevant business issues by sector and sub-sector.
- GRI, formed in 1997, produces the Sustainability Reporting Standards, which reflect economic, social, environmental, and governance issues. GRI contains disclosure requirements for the social elements such as stakeholder relations, Indigenous relations, human and employee rights, and board governance issues including diversity and executive compensation.

[28] SASB, "Promoting Clarity and Compatibility in the Sustainability Landscape," https://www.sasb.org/wp-content/uploads/2020/07/GRI-SASB-joint-statement_2020_07_13_FINAL.pdf.

ESG Evaluation

As referenced earlier, MSCI and Sustainalytics are examples of organizations that evaluate and rate company disclosure relative to peers. Broadly, they offer three services: (1) rating companies and providing reports to investors for a fee; (2) collecting and providing data to investors, who in turn conduct their own analyses; and (3) making decisions for investors by selecting issuers for inclusion in particular funds.

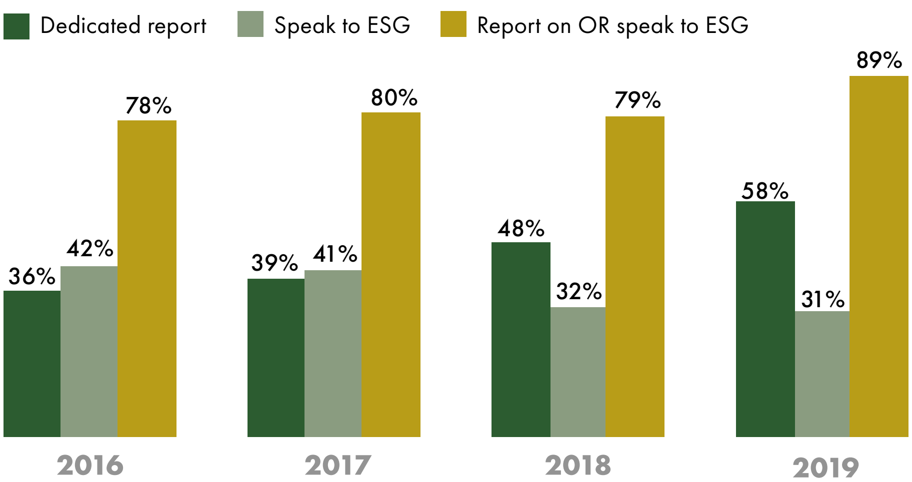
Every year, more companies report ESG factors, companies improve their disclosure, and organizations join the groups providing evaluation services. However, as the ground shifts from year to year, standards evolve and we have not yet seen stability or standardization in how companies are evaluated for their ESG performance relative to their peers. Even though a company may vastly improve its disclosure in a given year, if the peer group has kept pace or additional criteria have been added, its score may not improve.

According to SASB, the method by which companies disclose ESG factors is also shifting. Companies are increasing the inclusion of sustainability disclosure in annual reporting and other regulatory filings, like proxy circulars, rather than relying solely on corporate social responsibility (CSR) reports. In the Canadian context, the number of companies reporting on ESG has been rising, and 89% of S&P/TSX Composite companies report on or speak to ESG, compared to 79% in 2018.[29]

WHAT YOU NEED TO KNOW:

Ensuring your ESG disclosure is easy to find will help investors and the ratings agencies evaluate and report as accurately as possible. However, since the evaluation standards of both ESG disclosure and ratings agencies are constantly evolving, and year-to-year ratings can shift, companies can avoid wasting resources chasing ratings by focusing on their own journeys and continuous improvements in ESG disclosure, using TCFD, SASB, and GRI as guides. In short, tell your own story.

Companies Disclosing ESG Information



Source: Millani.[30]

Throughout this constant evolution, GRI and SASB have been collaborating, and TCFD and SASB have developed an integration guide, both of which will help the move towards a stable reporting environment.

[29] SASB, "GRI and SASB Announce Collaboration," https://www.sustainability-reports.com/gri-and-sasb-announce-collaboration/.

[29][30] Millani, "Millani's Annual ESG Disclsoure Study: A Canadian Perspective," https://c3a4c62d-4602-4b4f-a312-c6c7a40c2d99.filesusr.com/ugd/66e92b_aec2e16ccbdc4e998e17698316855439.pdf.

Sustainable Finance

Previously, we spoke on the increasing capital being driven into ESG investment tools and its impact on the share price. Along these lines, access to capital is also increasingly being considered in an ESG context.

Broadly, sustainable finance is based on considering ESG factors when making business or investment decisions, with an eye on long-term sustainability and benefits for all stakeholders. In 2019, the Canadian Expert Panel on Sustainable Finance published its final report and identified three main components of sustainable finance: (1) capital flows, including lending and investment; (2) risk management, including insurance and risk assessment; and (3) financial processes, including disclosures, valuations, and oversight. The panel sees the financial system as a key enabler of transition and lays out recommendations to help accelerate leveraging the financial system to address climate change and transition to a lower-emission economy.[31]

The Canadian market has responded. We have seen an increase in shareholder proposals related to sustainability issues (discussed in our "Trends in Activism" section), and more stringent voting guidelines from the major proxy advisory firms and certain Canadian investors. Most of the major Canadian banks have declared their goals, each allocating more than $100 billion to sustainable finance over the long term, and several banks, pension funds, and insurance companies have issued successful green bonds.[32]

Large investors like the Ontario Teachers' Pension Plan (OTPP) and Canadian Pension Plan Investment Board (CPPIB) are fully engaged in addressing climate change in their investments. OTPP recently joined investor Wellington Management and Woods Hole Research Centre to bring climate science into its valuations; and in July 2020, CPPIB updated its policy on sustainable investing to support companies whose reporting is aligned with TCFD and SASB.[33]

BlackRock's 2020 letter to CEOs, from Larry Fink, Chairman and Chief Executive Officer, highlighted the impetus for issuers to address climate change and said: "In the near future – and sooner than most anticipate – there will be a significant reallocation of capital." BlackRock is taking the management of climate change risks seriously, and it will vote against directors at companies that aren't adequately addressing them. In 2020, it voted against the directors of 53 U.S. companies where it believed not enough was being done. For 2021, it is watching an additional 191 companies for meaningful progress.[34]

WHAT YOU NEED TO KNOW:

In the long term, failing to consider, measure, and report on ESG factors will limit companies' ability to access capital. Investors are not looking for perfection, but they are looking for progress. Every journey begins with the first step.

[31] Government of Canada, Canadian Expert Panel on Sustainable Finance, "Final Report of the Expert Panel on Sustainable Finance – Mobilizing Finance for Sustainable Growth," https://www.canada.ca/en/environment-climate-change/services/climate-change/expert-panel-sustainable-finance.html.

[32] Cision PR Newswire, "CIBC announces $150 billion in Environmental and Sustainable financing by 2027," https://www.newswire.ca/news-releases/cibc-announces-150-billion-in-environmental-and-sustainable-financing-by-2027-833977960.

[33] Blackrock, "Larry Fink's Letter to CEOs: A Fundamental Reshaping of Finance," https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

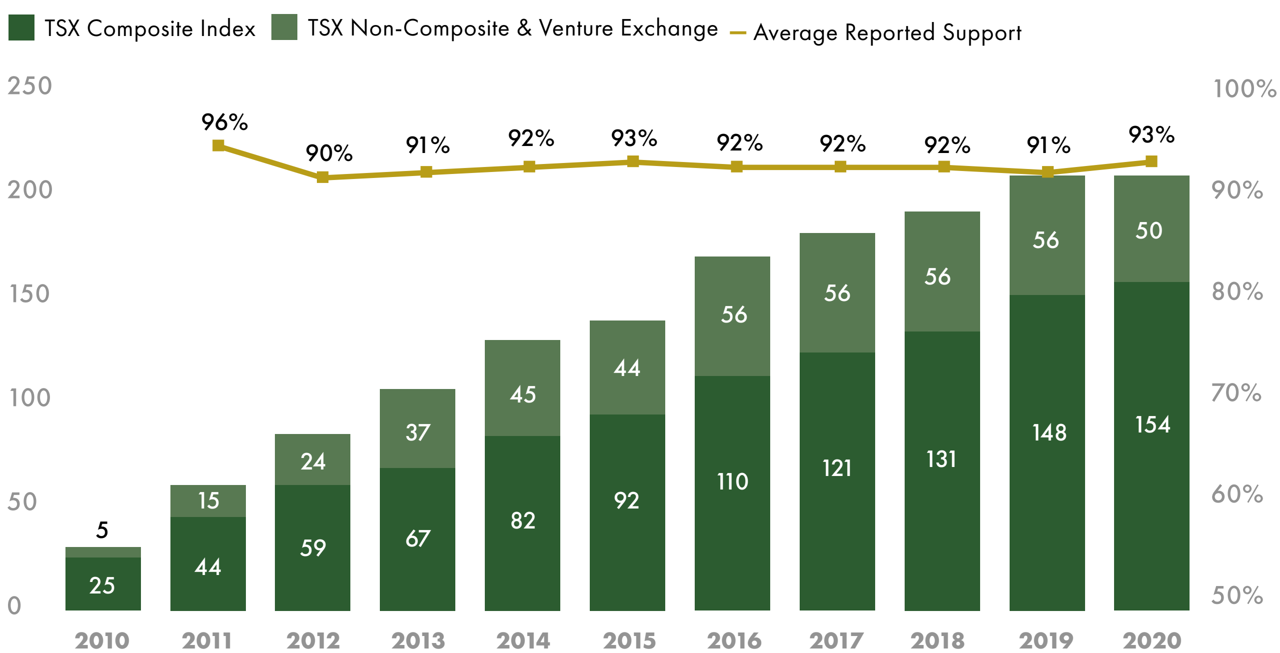
Executive Compensation and Say on Pay

Trends in say-on-pay resolution adoption, net adoption rates, and shareholder support

Say-on-pay resolutions have been increasing in number every year since their introduction in Canada in 2010. During that year, there were only 30 say-on-pay resolutions, whereas we have seen 204 so far in 2020 (including resolutions on the agendas of meetings that have not yet taken place). This year marks the first where the number of resolutions has not grown from the previous year; although this number may skyrocket once the *Canada Business Corporations Act* (CBCA) amendments take effect and companies formed under the CBCA will be required to hold an annual say-on-pay vote.

Of the 204 say-on-pay resolutions this year, 154 were for TSX Composite Index constituents, representing about 70% of the companies in the index. The composite index currently has 221 constituents and contains the largest publicly listed companies in Canada, representing about 87% of the market capitalization of all publicly listed companies in the country. It has generally become a "best practice" for composite index constituents to hold an annual say-on-pay vote, and many large institutional investors actively encourage composite index constituents to hold these votes. Examples of this moral suasion include a letter-writing campaign by AIMCo and BlackRock's annual open letter to CEOs.

Say-on-Pay Resolutions vs. Average Support



Data courtesy of ISS Corporate Solutions.

As shown above, say-on-pay votes for composite index companies increased by six from 2019 to 2020; while for non-composite companies, the number of annual votes went down by six. What can explain this churn from non-composite to composite? Were there six new adopters among composite index companies, and six non-composite companies that decided to stop their annual say-on-pay vote? In our experience, it is unlikely that issuers decided to stop having say-on-pay votes, as this would not bode well with their shareholders. Once a company adopts an annual say-on-pay vote, shareholders expect that vote to continue indefinitely. The explanation is simply a combination of things that affect the number of say-on-pay votes in each of those two cohorts:

(1) Issuers are no longer publicly traded, usually as a result of M&A;

(2) Issuers have been removed from or graduated to the composite index, which would change the cohort in which they appear;

(3) Companies have redomiciled into or out of Canada; and, of course,

(4) Companies decided to start holding annual say-on-pay votes.

Accounting for these transitions, there are now more composite index companies with say-on-pay votes, and there continues to be a certain level of churn in the non-composite category. We expect this trend to continue into the future.

Increased Proxy Advisor and Shareholder Support for Say-on-Pay Resolutions in 2020

Support for say-on-pay resolutions was near an all-time high in 2020, at 93%. ISS supported every say-on-pay resolution in Canada this year, whereas in previous years it had opposed anywhere from two to 12 resolutions. Every say-on-pay resolution carried at its respective meeting, whereas in the past, between one and three resolutions were defeated at shareholder meetings each year. An important factor this year in proxy advisor recommendations and shareholder support was definitely COVID-19. Anecdotally, there were some meetings at which ISS or Glass Lewis had identified serious concerns regarding a company's approach to executive compensation – either a disconnect between stock performance and total compensation, or disconnection between the pay practices of the subject company from the pay practices of a proxy-advisor-selected peer group. However, because of the severe and sudden impact of COVID-19 on capital markets and the uncertainty it created, the proxy advisors seemingly avoided making negative recommendations.

It may appear that the proxy advisors "went easy" on the say-on-pay outliers this year. Nevertheless, each advisor has issued guidance that it will continue to evaluate how executive compensation payouts align with business performance (and TSR performance), and whether those targets are robust. Companies that restate their performance targets for mid-flight awards, regardless of whether this is as a result of COVID-19, may find some pushback and negative recommendations from proxy advisors in 2021.

As we head into 2021, uncertainty continues surrounding COVID-19, especially given the spike in cases in September 2020. We expect proxy advisors to update the market regarding the temporary COVID-19 guidance released in April that applied to meetings held in 2020, and whether similar guidance will continue to apply in 2021. What will be telling, is to what extent the proxy advisors are going to apply a degree of leniency in their say-on-pay recommendations consistent with how severely certain industries have been impacted. For instance, mining companies are generally performing better than before COVID-19 and will likely have no COVID-19-related leniency applied, whereas airlines and travel industries continue to languish directly as a result of COVID-19 and will likely be viewed through a more lenient lens.

Weak Shareholder Support and Board Responsiveness

Obviously, a say-on-pay resolution that fails to get at least 50% support requires some response by the company – both in terms of how much is paid to executives in total compensation, and the process and performance metrics that lead to executive pay outcomes. In 2020, no Canadian companies found themselves in this position, as the say-on-pay resolutions passed at every meeting.

At the opposite end of the spectrum, any say-on-pay resolution with higher than 80% in favour is considered overwhelming support by proxy advisors and shareholders alike. In such cases, there will not be an imperative for the company to include a special response to address the minority of negative votes and those underlying shareholder concerns in the upcoming year's proxy circular.

The middle ground, with vote support between 50% and 80%, is the warning track in the outfield; and companies should not ignore shareholder concerns simply because the resolution carried at the meeting. The board responsiveness policy of the proxy advisors is applicable in this range. Specifically, in cases where the resolution has passed, but the proxy advisors look for the company to address concerns that exist among the significant minority group of shareholders that voted against the resolution. A robust response by a company would include additional disclosure in the circular for the next AGM, such as:

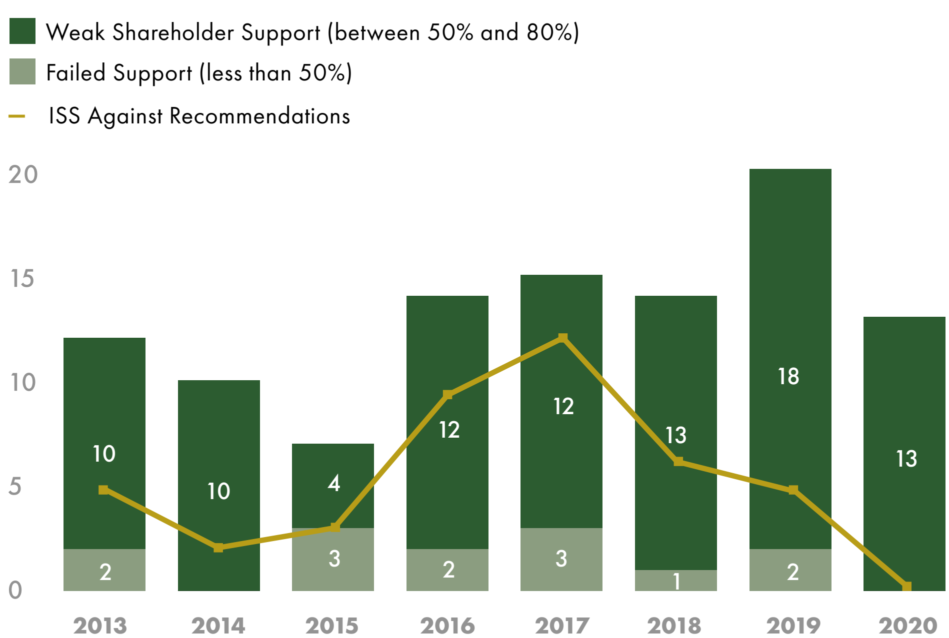
- What were the concerns regarding executive pay practices among both shareholders and/or proxy advisors?
- What changes did the issuer make to its executive compensation program to remedy these concerns?

In the absence of this disclosure, shareholders often vote against the say-on-pay resolution at the next AGM for the issuer's failure to respond to the significant concerns from the previous year. Proxy advisors may also issue a negative recommendation for this factor alone, regardless of whether pay-for-performance alignment has improved.

To this point, of the 18 say-on-pay votes with weak support observed in 2019, all of them had some form of response included in their 2020 circular. Notable remedial actions taken were: reducing the use of stock options as executive compensation; reducing the annual bonus to executives; adding performance vesting conditions to RSU award grants in future years; and adopting risk management policies, such as anti-hedging or clawback. Responses in 2020 circulars to the concerns identified in 2019 were sufficiently addressed so that no proxy advisor issued a negative recommendation based on a lack of company response.

The chart below shows weak shareholder support in 2020. While none of the say-on-pay resolutions failed this year, 13 companies (down from 18 in 2019) are in the "weak support" category, and have some explaining to do in their circulars next year.

Say-on-Pay Resolutions Requiring a Board Response



Data courtesy of ISS Corporate Solutions.

CBCA Amendments Requiring Mandatory Advisory Votes on Executive Compensation

While voluntary adoption of say-on-pay resolutions has stalled, certain amendments to the CBCA will require companies formed in that jurisdiction to hold annual say-on-pay votes. This obligation is not yet in effect, and it is not clear when it will be. When this amendment does take effect, we can expect to see a dramatic increase in annual say-on-pay votes in Canada – it could result in an additional 500 say-on-pay votes, unless exemptions are made available for smaller issuers.

This dramatic increase will cause proxy advisors to rethink the level of detail they provide in their analysis, based on the size of the company. Currently, proxy advisors provide a thorough peer group analysis for any company that holds an annual say-on-pay vote. This is generally appropriate, since almost all companies that hold voluntary annual votes are large and mature, with significant revenues and operations, and with comparably sized peers that makes peer group analysis meaningful. When faced with hundreds of first-time say-on-pay adopters, proxy advisors may roll out a shorter analysis for smaller companies. We don't expect a full peer group comparison, but rather a simple analysis of the directionality of executive compensation versus the stock price performance of the company over the past three years. As long as executive pay is not increasing year over year against a backdrop of poor total share returns, companies can generally expect favourable proxy advisor recommendations and positive support from shareholders.

ESG Performance Metrics for Executive Compensation Payouts

As discussed earlier, environmental, social, and governance (ESG) factors have increasingly been influencing portfolio managers – both for investment decisions and, where applicable, governance groups in their voting decisions. ESG factors have been slowly working their way into executive compensation decisions by boards. In addition to financial and operational performance metrics for annual cash bonuses and long-term equity incentive awards, it is now common among larger TSX companies to find ESG factors such as safety, carbon footprint, and sustainability. The various sectors relate to ESG differently, and the use of ESG factors in executive compensation varies too. Obviously, carbon footprint is more relevant to extractive industries than technology companies, and these industries would have different targets that would constitute successes.

In the coming years, proxy advisors will be expected to apply more scrutiny to how companies integrate ESG-based performance metrics into executive compensation, and how much of the total weighting these metrics have. Companies and boards who opt for less-regimented payout schemes, with more board discretion, should at least include disclosure in the executive compensation section of the circular regarding which ESG factors are considered in determining bonuses.

2020 First Year of EVA for ISS

This was the first year that Institutional Shareholder Services (ISS), a leading proxy advisory firm that provides voting recommendations to investors, used its Economic Value Add (EVA) metric to evaluate executive compensation pay-for-performance alignment. The EVA metric joined ISS' three other longstanding measures: Relative Degree of Alignment, Multiple of Median, and Pay-TSR-Alignment. While the original three measures focus on total compensation and TSR relative to an ISS-selected peer group, EVA focuses more on operational health. EVA uses financial metrics to determine how the company is performing relative to its peers in its ability to generate economic profit – which should necessarily translate into long-term shareholder value. EVA represents a way by which ISS can bolster its confidence for its recommendations. If the first three measures indicate pay-for-performance misalignment relative to the peer group, and EVA also shows that the company's ability to generate economic profit relative to its peers is also lagging, then there is a stronger case for a negative recommendation.

In the inaugural year of the EVA metric, ISS Canada did not make any negative recommendations, despite some reports showing that the EVA performance relative to the peer group was poor. Because 2020 was the year of COVID-19, ISS may have used that fact to override some negative recommendations and instead take a wait-and-see approach. It could also be that issuers and their advisors have generally gotten the message from shareholders and proxy advisors about pay for performance: if TSR performance has lagged, then executive compensation should not be increasing year over year; otherwise, shareholders will likely vote against the say-on-pay resolution.

Glass Lewis's New Data Provider, New Peer Groups and New Charts for Executive Compensation Analysis

Up until the end of the 2019 proxy season, Glass Lewis was using Equilar's data and peer group construction methodology for its executive compensation analyses. Starting in 2020, Glass Lewis switched to CGLytics. This switchover meant a few significant changes for issuers:

- CGLytics uses its own proprietary peer group selection model. Issuers probably noticed a change in companies that were used by Glass Lewis in its executive compensation analysis.
- Glass Lewis added new charts to compare company compensation levels, and TSR performance against:
  - the CGLytics-selected country peer group, and
  - the CGLytics-selected industry peer group.
- Glass Lewis now compares financial ratios of the company against the country and industry peer groups. Financial ratios used are EPS, ROA, ROE, and ROIC. This approach is very similar to ISS' predecessor to EVA, which was called the "Financial Performance Assessment." It is not clear how this information informs voting recommendations, and at this point it may only be provided for informational purposes for the reader.

Equity Compensation Plans

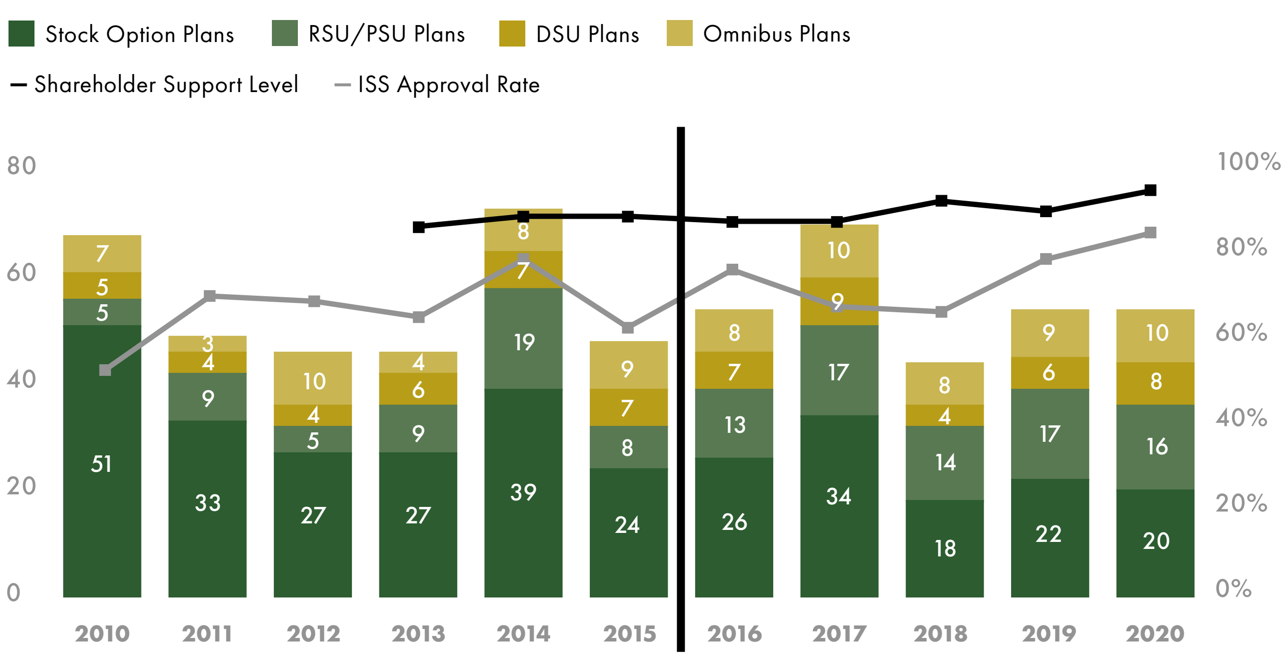
One type of resolution for which there is significant shareholder opposition every year is the approval of equity compensation plans. Shareholders always scrutinize those plans which may be dilutive and costly. The proxy advisors each have policies regarding the approval of these plans, which take into account: potential dilution, costs of awards, burn rate, and certain shareholder-friendly plan provisions.

Over time, TSX Composite Index companies have been moving away from stock option plans in favour of less-dilutive, full-value award plans such as RSUs, PSUs, and DSUs. PSUs are preferred to RSUs since the awards do not just simply vest over time, but they also vest contingent upon achievement of certain performance conditions. The chart below shows the decreasing use of stock option plans from over 50 stock option plan approval resolutions in 2010 to just 20 plans seeking approval from shareholders in 2020. As well, there were only 17 full-value award plan proposals in 2010, and this is now up to 34 annual approvals in 2020.

Also shown in the chart below is a vertical black bar to indicate ISS' shift in analysis in the 2016 proxy season from their older-style methodology, which just considered whether dilution was in excess of ISS' benchmark and whether there was any one of three overriding negative factors. The new methodology is the Equity Plan Score Card (EPSC), which assigns a score to each of a set of about 12 weighted factors. Scores over 50 out of 100 receive a passing grade (absent any overriding negative factors).

Since the introduction of the EPSC, ISS' positive recommendation rate has been trending upward. So too has the average support level of shareholders. The increase in ISS support is likely because the analysis no longer has a cut-off point drawn in the sand that issuers had to guess as to whether the dilution of the plan was considered excessive for ISS. It also stands to reason that the increase in shareholder support likely results from more positive recommendations made by ISS.

TSX Composite Index Equity Compensation Plans



Data courtesy of ISS Corporate Solutions.

Diversity

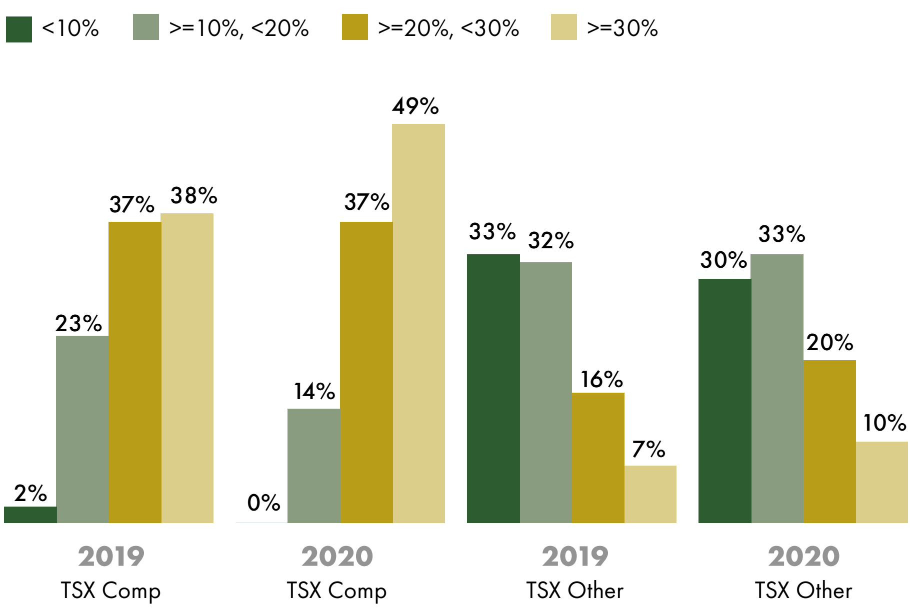
Representation of Women on Boards in Canada

In Canada, the representation of women on boards has steadily increased year over year. 2020 marks the first year where there were no companies with all-male boards among all those listed in the S&P/TSX Composite Index. While having one woman on a board is better than none, and represents a step in the right direction for many issuers, the fear is that some boards might think that "one and done" is as far as they need to go.

Certain organizations in Canada and around the world promote higher standards of inclusion for women on boards, and push for higher representation levels in executive positions. It is not uncommon among institutional investors to have policies that promote a minimum of either three or 30%. One such organization, the 30% Club, states its "global mission is to reach at least 30% representation of all women on all boards and C-suites globally." In Canada, the 30% Club's goal "is for 30% of board seats and C-Suites to be held by women by 2022." As well, its approach is different than others in many European countries that have instituted quotas for female board representation, such as in Sweden, Norway, and Spain. The 30% Club Canada does not "believe mandatory quotas are the right approach. Instead, we are building a strong foundation of business leaders who are committed to meaningful, sustainable gender balance in business leadership."

Overall, the percentage of board seats held by women for all companies on the TSX Composite Index currently stands at 26.6%. The proportion of TSX Composite Index issuers with at least 30% women on the board is now 49%, up from 38% last year. The following histogram shows how the representation of women on boards has increased from 2019 to 2020.

Proportion of Women on Boards, TSX Composite Index vs. TSX Non-Composite



All figures as of June 30, 2019 and June 30, 2020.

Source: ISS Governance Research & Voting.

New CBCA Disclosure Requirements

New for the 2020 proxy season was the requirement for companies formed under the *Canada Business Corporations Act* (CBCA) to disclose the number and percentage of directors and executives who are members of each of the following "designated groups":

- women,
- Aboriginal persons,
- persons with disabilities,
- members of visible minorities,
- plus, any other group the corporation wishes to include in its designated groups.

Companies were also required to disclose whether there was any target level of representation adopted for each group. If not, they needed to provide an explanation.

Since this was the first year of the new requirements, disclosures varied greatly among issuers. Some used only a couple of sentences to disclose the bare minimum requirements, and aggregated the numbers and percentages for all designated groups into a single diversity disclosure number. Others devoted up to an entire page in the circular to explain to shareholders the groups under assessment, and the specific representation of each group in both management positions and on the board. Over time, it is expected that the disclosures will converge on a generally accepted "best practice." For an example of what good disclosure looks like, companies can refer to those of National Bank of Canada and SNC-Lavalin Group Inc. It should be noted that National Bank is not governed by the CBCA, but rather by the *Bank Act*; and even though it is not subject to this new requirement, it voluntarily and proactively started laying the ground work for this type of disclosure in December 2018.

As is always the case, companies need to approach their disclosure in a thoughtful manner and with alignment of their goals. Similar to with environmental, social, and governance (ESG), the board and executives need to lead the way on diversity and inclusion initiatives. As a starting point, the letter noted earlier from State Street Global Advisors provides an excellent foundation for building a successful program. Essentially, by defining a strategy; defining the goals; defining the metrics; having the board lead the way; and ultimately, having the board provide the oversight.

Developments in the Promotion of Diversity in Canada

Proxy Advisors and Diversity

Currently, neither proxy advisor has a voting policy regarding the representation of visible minorities on boards. However, in ISS' most recent annual policy survey, it appears to be taking the temperature on the marketplace for the development of such a policy. This idea is still in the early stages, and even if there was a positive response by ISS clients and other market participants, it seems unlikely at this point that ISS would enact a new policy regarding racial diversity for the 2021 proxy season. One barrier to enacting a new policy is the lack of relevant disclosure by issuers regarding racial diversity. ISS cannot make recommendations if the underlying data is not readily available. However, with the new CBCA disclosure rules, some issuers are now required to provide enough data on which ISS could make recommendations. The other hurdle is that this data is not widely mandated, and there may be pushback from issuers if some companies are subject to a future racial diversity policy while others are not. Ultimately, it will be ISS' clients, the large institutional shareholders, who will decide whether a racial diversity voting policy is desirable or not. Even in the absence of proxy advisor voting policies, some institutional investors may choose to apply their own custom policy for the representation of minorities on boards.

Capital Markets Modernization Taskforce and Diversity

One of the topics being tackled by Ontario's Capital Markets Modernization Taskforce (Taskforce) is improving corporate board diversity. Specifically, the Taskforce has suggested that TSX-listed companies should be required to disclose and set targets regarding the representation of women, Black people, Indigenous people, and People of Colour, on boards and in executive officer positions. This differs from the new CBCA rules in that it does not address the representation of people with disabilities. If adopted, this would be the foundation for disclosure that would allow proxy advisors and institutional investors to begin to make voting decisions on the basis of more than just the representation of women on boards.

Responsible Investment Association and Diversity

The Responsible Investment Association is also leading the way in promoting diversity in capital markets in Canada. On October 1, 2020, it announced that institutional investors managing more than $2.3 trillion in assets have signed the new Canadian Investor Statement on Diversity & Inclusion. Signatories to the statement, which include some of the largest institutional investors in the country, acknowledge the existence of systemic racism and its impacts on Black and Indigenous communities and People of Colour, while further acknowledging the existence of inequities and discrimination based on other factors including, but not limited to, gender, sexual orientation, age, disability, religion, culture, and socio-economic status.

The joint statement declares: "We all have a responsibility to ensure that the persistent inequities in business and our society are eliminated. As institutional investors, we can contribute to addressing these inequities in Canada by taking intentional steps to promote diversity and inclusion across our portfolios and within our organizations."

Virtual Meetings

Up until 2020, there was only a handful of companies that held virtual-only meetings. In Canada, the practice was seen as a way by which the management of a flagging company could avoid the tough questions that shareholders would pose in-person at an AGM. Concordia Healthcare Corp., one of the first companies in Canada to hold a virtual-only meeting, took criticism in the marketplace in 2017, when it held a virtual meeting in the wake of its massive stock price losses. Shareholders and market commentators speculated that the decision to hold a virtual meeting was, in part, to avoid security concerns with a room full of angry shareholders.

Since 2017, virtual meetings slowly gained popularity in the U.S. for normal-course AGMs, and were not just used to avoid confrontations with shareholders. Meanwhile, in Canada, there were only a few virtual-only meetings each year. COVID-19 changed everything. Once the pandemic became a real threat to North America in February 2020, almost all companies immediately switched to virtual-only meetings for their 2020 AGMs. The proxy advisors quickly provided guidance, indicating that virtual-only meetings would generally be acceptable for this season, with the expectation that companies will revert back to in-person or hybrid meetings as soon as practicable when the pandemic has concluded. At this point, it is not clear whether the proxy advisors will support 2021 virtual-only meetings; however, with the recent uptick in COVID-19 infections, companies can probably expect to have another season of virtual-only meetings.

SEC Proxy Advisory Firm Updates

This July, the U.S. Securities and Exchange Commission (SEC) approved new proxy rules applicable to proxy advisory firms, such as ISS and Glass Lewis, with effect for the 2022 proxy season. The SEC adopted the rules, "so that investors who use proxy voting advice receive more transparent, accurate, and complete information on which to make their voting decisions, without imposing undue costs or delays that could adversely affect the timely provision of proxy voting advice."[35]

The SEC will now treat proxy advisor voting recommendations as "solicitations," subjecting them to a higher standard of accuracy and potentially opening the door to lawsuits. The new rules will require proxy advisors, in order to qualify for exemptions from proxy information and filing requirements applicable to solicitations, to (i) disclose conflicts of interest in their reports, (ii) provide companies with copies of their reports – at no cost – concurrently upon delivery to their subscribers, and (iii) publish company rebuttals in revised reports. Notably, the final rules did not contain an earlier proposal that would have given companies an opportunity for advance review and comment on these reports.

The new rules are the culmination of a decade-long SEC process, driven in large part by U.S. business advocates. These advocates have contended that the proxy advisors have enormous and outsized influence over the proxy voting process (particularly as it relates to voting by those clients who do not perform their own independent analyses and vote automatically in line with recommendations), that reports are rife with errors, and that the industry operates with conflicts of interest.

The new rules have been bitterly opposed by investors and shareholder-rights advocates who have rejected many of these claims:

> *"This is not a rule that investors wanted. In fact, there was near-unanimous investor rejection, many of who implored the SEC and others to keep their hands off the independent advice they purchase. They pay for this advice so they are aware of disparate views on these issues, all with the goal of better serving their investment clients, including millions of pensioners."*[36]

The U.S. Council of Institutional Investors has expressed concerns in respect of potential delays in the distribution of proxy advice, and how the new rules may impair the independence of proxy advice:

> *" ... the new rules and guidance seem to effectively require investment advisors who vote proxies on behalf of investor clients to consider and evaluate any response from companies to proxy advice before submitting votes. That could cause significant delays in the already constricted proxy voting process. It also could jeopardize the independence of proxy advice as proxy advisory firms may feel pressure to tilt voting recommendations in favor of management more often, to avoid critical comments from companies that could draw out the voting process and expose the firms to costly threats of litigation."*[37]

ISS and Glass Lewis, not surprisingly, have also been vocal in their opposition. ISS initiated a lawsuit against the SEC last year, challenging the determination that proxy voting advice constitutes a "solicitation."

ISS and Glass Lewis already offer ways for issuers to verify the accuracy of their reports. ISS allows for constituents of the S&P Composite Index to review a draft of its proxy report and provide feedback prior to it being released. Glass Lewis provides issuers who sign up on its website the ability to verify the quantitative data used in formulating its reports. Starting this year, Glass Lewis also introduced a Report Feedback Statement, available at "no cost" to issuers who subscribe to its reports, which gives companies an opportunity to provide unedited feedback that Glass Lewis will publish in revised reports.

WHAT YOU NEED TO KNOW:

Canadian companies will not see any immediate impact, given that the new rules will not apply to securities of most Canadian companies registered with the SEC; most will be eligible for an exemption available for foreign private issuers. However, Canadian regulators are undoubtedly monitoring U.S. developments, and we may yet see similar rules here in Canada. Notably, Ontario's Capital Markets Modernization Taskforce, in its July 2020 consultation report, proposed a regulatory framework for proxy advisory firms that would give issuers a right to rebut voting recommendations and would restrict these firms from providing consulting services to issuers where such firms also provide clients with voting recommendations.

[35] U.S. Securities and Exchange Commission, "Exemptions from the Proxy Rules for Proxy Voting Advice," https://www.sec.gov/rules/final/2020/34-89372.pdf.

[36] Nasdaq, "Is The SEC Proxy Proposal Analyst Retaliation?" https://www.nasdaq.com/articles/is-the-sec-proxy-proposal-analyst-retaliation-2019-12-03.

[37] Council of Institutional Investors, "Leading Investor Group Dismayed by SEC Proxy Advice Rules," https://www.cii.org/july22_sec_proxy_advice_rules.

Capital Markets Modernization Taskforce

Ontario's Capital Markets Modernization Taskforce (Taskforce) was established by the Ontario government in February 2020 and delivered its consultation report in July 2020. The Taskforce was charged with reviewing Ontario's securities regime and looked at a number of recommendations to improve capital markets. The process was open to comments until September 7, 2020, and the Taskforce is expected to deliver its final recommendations by the end of 2020.[38]

Final recommendations being contemplated, among other things, are with respect to diversity (disclosing data on Black, Indigenous, and People of Colour representation on the board of directors and in executive officers, with targets), director term limits (10 years maximum and 12 years for up to 10% of the board), universal proxy ballots for contested meetings (discussed in our "Trends in Activism" section), ESG disclosure (requiring TSX-listed companies to use either or both of Sustainability Accounting Standards Board [SASB] and Task Force on Climate-related Financial Disclosures [TCFD]), the reduction of the early-warning reporting threshold (from 10% to 5%), and increasing investor filings frequency (from semiannually to quarterly).

2020 ISS Survey Response

Each year, Institutional Shareholder Services (ISS) conducts its Global Benchmark Policy Survey on specific areas of its voting policies to gather feedback from its stakeholders, including board members, corporate executives, and institutional investors. The results inform the future development of ISS' voting polices. As such, questions with high levels of support from survey respondents point to probable changes to ISS voting policies in the years to come.

This year, ISS received a total of 519 responses. Of these, 175 were investors consisting of asset managers, asset owners, advisors, etc. The remaining 344 respondents were non-investors such as public corporations, public corporation board members, advisors, etc. The primary market of focus for this year's respondents was mostly global and U.S., and nearly 90% of respondents represented assets under management of over $1 billion.

Below is a summary of ISS' key findings from this year's global categories that are applicable to the Canadian jurisdiction:

COVID-19-Related Questions

1. The Application of ISS' Ongoing "Flexible" Global COVID-19 Guidance

In April 2020, ISS released an update providing guidance surrounding greater flexibility in response to the COVID-19 pandemic. It touched on a number of topics, including shareholder rights, poison pills, board and executive changes, compensation problems, dividends, AGM meeting postponements, virtual-only meetings, capital raising, and share repurchases. ISS asked survey respondents their opinions on keeping this COVID-19-related guidance in the new year, and if so for how long and to cover which areas.

Overwhelmingly, investors and non-investors supported the continuance of ISS' COVID-19 guidance into 2021 (investors 62%, non-investors 87%).

[38] Ontario Capital Markets Modernization Taskforce, "Capital Markets Modernization Taskforce: Consultation Report," https://files.ontario.ca/books/mof-capital-markets-modernization-taskforce-report-en-2020-07-09.pdf.

2. Global Virtual-Only Shareholder Meeting Mechanics

COVID-19 has played a direct role in the change of the allowance of virtual-only and/or hybrid meetings in numerous new jurisdictions. Currently, ISS policy does not provide adverse recommendations to company directors that choose to adopt a virtual-only meeting. In response to the surge in virtual-only meetings, ISS asked surveyees this year which meeting format is most desirable.

Hybrid meetings were the preferred choice by 77% of investor respondents, while there was no consensus among non-investors between all three meeting formats (42% in-person, 31% hybrid, 27% virtual only).

3. Global Changes to Executive Compensation

ISS is aware that many short- and long-term compensation changes are being made by boards amid challenging conditions from the COVID-19 pandemic; therefore, it is gathering feedback from surveyees on what they believe should be a realistic response to changes in company executive compensation regimes.

Overwhelmingly, investors agreed that reasoning on adjusting pay should be clearly disclosed (70%), compared to 33% from non-investors. A majority of non-investor respondents believed that boards will need flexibility (53%).

4. Global Incentive Program Adjustments, Both Short Term and Annual

When ISS released its initial COVID-19 guidance in April 2020, it advised that companies should generally avoid in-flight changes or restatements of performance goals as a result of the pandemic. However, as a result of economic shifts due to COVID-19, companies have been making adjustments to executive incentive programs.

ISS asked respondents to identify which option best aligned with their organization's view on a reasonable company response given current market conditions. A majority of investors and non-investors supported both mid-year program adjustments and suspending annual incentive programs, and alternatively making one-time awards based on committee discretion (51% investors, 54% non-investors).

This feedback may cause ISS to rethink its initial guidance. The actual impact of COVID-19 on publicly listed companies, and the widespread support for restatement of performance goals, could not have been accurately predicted by ISS in April.

Non-COVID-19-Related Global Questions

5. Global Monitoring of Climate Change Initiatives

ISS is a firm believer of companies monitoring and responding to climate/environmental risks associated with not only their direct business, but on a more macro scale. This year, ISS sought feedback from survey respondents on how shareholders could hold companies responsible in situations where they do not properly communicate or mitigate risks of this nature.

Investors and non-investors both strongly supported engagement with the board and company management on their concerns as the most appropriate action to take (investors 92%, non-investors 93%). Shareholder proposals were a close second and third for investors as appropriate actions to take.

6. Global Sustainability Structure

This year, ISS built its questions around the United Nations' 17 interconnected Sustainable Development Goals (SDGs). Survey respondents were asked their opinion on the effectiveness of the SDGs for measuring environmental and social risks. ISS also asked respondents if their respective companies believe a different structure outside of the SDGs is more effective.

Both investors and non-investors were virtually split between yes and no regarding the effectiveness of the SDGs. A majority of investors and non-investors cited the Sustainability Accounting Standards Board (SASB) as a more effective structure (investors 82%, non-investors 60%).

7. Global Auditors and Audit Committees

ISS' questions this year revolved around the ongoing issues surrounding company-related fraud allegations. Its first question asked surveyees to identify which elements would affect auditor independence outside of the standard non-audit-related fees in comparison to audit-related fees. Another question asked them to consider what type of dispute with another client would be significant enough to impact their view of the lead audit partner. Finally, ISS asked surveyees to provide the criteria investors should be reviewing when assessing the audit committee.

The most important issues for investors were: significant audit controversies (88%); significance/frequency of material restatements of financial results by the company due to errors, omissions or misconduct (83%); regulatory fines or other penalties on the company related to financial disclosure practices or weaknesses not identified in the audit report (82%); and regulatory fines or other penalties on the auditor for weaknesses or errors in audit practices (82%).

The most important issues for non-investors were: significance/frequency of material restatements of financial results by the company due to errors, omissions or misconduct (67%); and identity of the lead audit partner(s) and any significant links to the company or its management (59%).

Overwhelmingly, investors and non-investors said they would consider a situation where the lead audit partner has been tied to a significant auditing controversy at one or more other companies (investors 79%, non-investors 67%).

When asked about the top criteria that should be considered by shareholders in evaluating an audit committee, both investors and non-investors selected significant controversies relating to financial reporting, financial controls or audit (investors 93%, non-investors 74%); and skills and experience of audit committee members (investors 92%, non-investors 97%).

8. Global Board Diversity (Racial and Ethnic)

ISS asked respondents three questions relating to the current movements and protests targeting racial and ethnic inequality, along with what is believed to be insufficient levels of representation and disclosure for individuals of these groups within the director and executive classes. One of these questions includes whether boards should be required to disclose the composition of those individuals which self-identify as a certain ethnicity and/or race. The other two questions revolve around gathering surveyees' opinions on the importance of ethnically/racially diverse boards.

A majority of investors believed that boards should disclose this information to the fullest extent possible and permitted under relevant laws (73%). Non-investors were split between that option (36%), and that boards should only disclose this information where it is mandated in jurisdictions where they operate (32%).

A majority of investors responded that boards should aim to reflect the company's customer base, and the broader societies in which they operate, by including directors drawn from racial and ethnic minority groups (61%). However, a majority of non-investors believed that while board diversity is desirable, expectations may reasonably differ based on many factors, for example, local laws, company size, geographic location, and other factors (53%).

Overwhelmingly, to increase diversity at their portfolio companies, investors and non-investors ranked engagement with the board and management team to encourage the inclusion of racially and ethnically diverse directors as the more appropriate action to take (investors 85%, non-investors 92%).

WHAT YOU NEED TO KNOW:

Based on the responses of surveyees, we can expect some near-term updates from ISS. On a broader scale, ISS' COVID-19 guidance is anticipated to continue into 2021. Specifically, we can expect ISS to update the market on its view regarding performance goals and the continued reliance on virtual-only meetings for the 2021 proxy season.

This year, investors and non-investors alike showed overwhelming support for board and management engagement in cases where the company fails to properly communicate or mitigate climate/environmental risks. Based on this question from ISS and the support level from both groups of surveyees, ISS may be examining ways to amend its policy guidance to hold companies more accountable for climate/environmental risks. It could be expected that, in the future, ISS will provide adverse voting recommendations in cases where companies fail to properly address these risks within their unique corporate landscape.

Other policy updates that we can probably expect further in the future relate to enhanced ESG disclosures, a broader view of diversity beyond just women on boards that includes the representation of racial minorities on boards and in management, and more detail about external auditors that could be used to determine their independence.

Trends in Corporate Governance

2020

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