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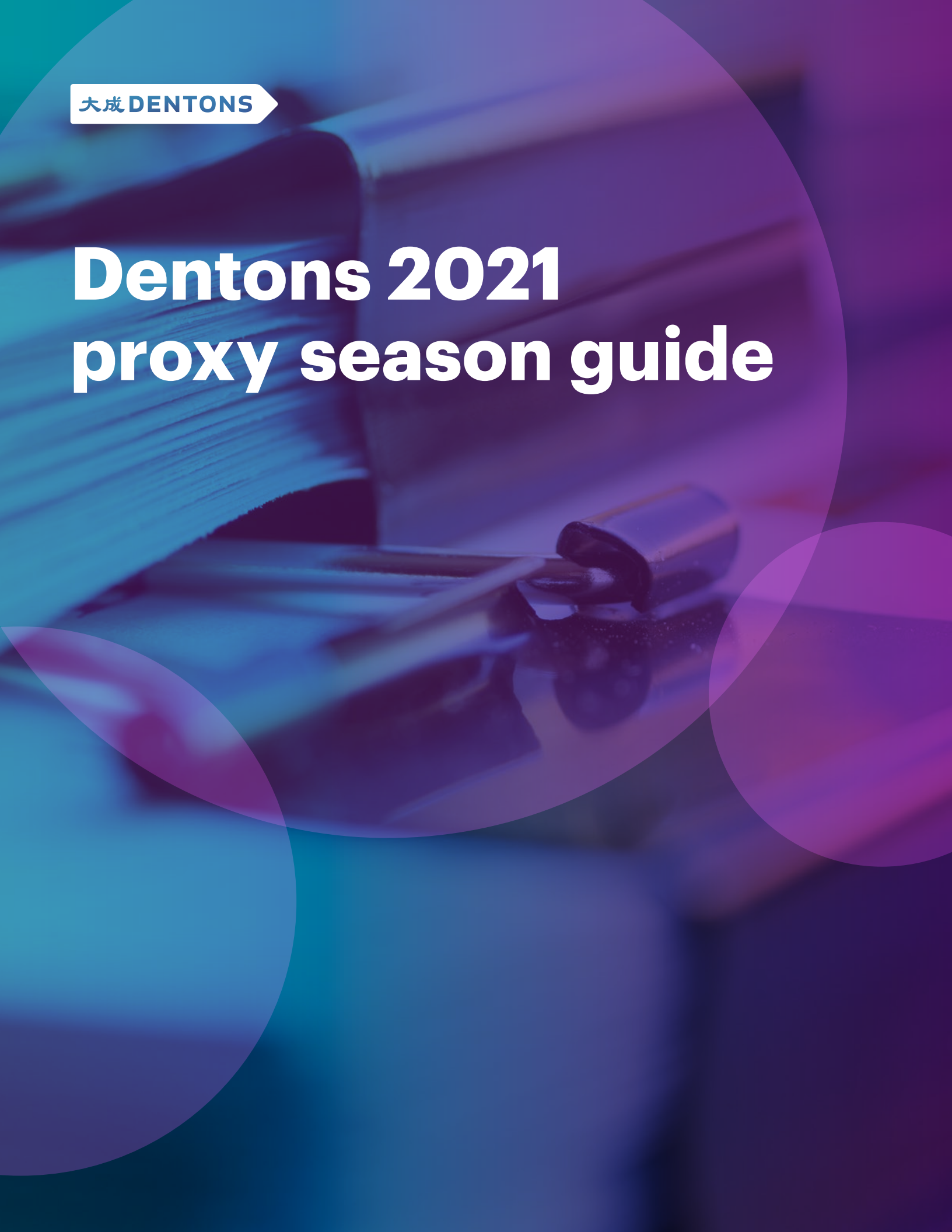
Dentons 2021 proxy season guide



This alert sets out legislative, regulatory and "advisory" developments in respect of corporate governance and annual disclosure matters. These will impact Canadian public companies when preparing their proxy-related materials and other annual disclosure. The focus is on the 12 months to February 2021, with some reminders about continuing developments and future matters.

Developments this year are fewer than in recent years, in part due to governments, regulators and others having their focus diverted during the pandemic. There have, however, been several rule changes and guidance statements that will impact proxy and annual disclosures, and signals as to significant changes to come, as described below.

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I. New developments

1. CSA continuous disclosure review report

Staff of the Canadian Securities Administrators (CSA) conducts reviews of disclosure by issuers and insiders on an ongoing basis, and reports on those reviews every other year. The most recent report, from October of 2020, focused largely on financial statements and management's discussion and analysis (MD&A) but also flagged a recurring error in circular disclosure.

We summarized the full report in a previous Insight. Some of the issues relevant to proxy season are:

A. Circular and Annual Information Form (AIF) disclosure

The report notes discrepancies in insider reporting practices, which are applicable to issuers as well as insiders. One is inconsistent disclosure of insiders' security-holdings by the issuer (in its AIF and circular) vs. the insiders in their reports filed on the System for Electronic Disclosure by Insiders (SEDI).

The report also flags that SEDI reports related to securities issued under compensation arrangements are often either not filed, are filed with errors or are filed late. Some issuers, with the authorization of their insiders, make such SEDI filings on behalf of their insiders.

B. Financial statements and MD&A

The report also highlights common deficiencies with respect to financial reporting. This includes valuation of intangible asset acquisitions, impairment of non-financial assets such as goodwill, and operating segment disclosure.

Regarding MD&A disclosure, the report identifies "hot button" issues such as forward-looking information or FLI, liquidity and capital resources, and related party transactions.

Regulators often highlight deficiencies in FLI disclosure, which exists in much of the disclosure record of a typical issuer. In our summary of the review report, we set out the applicable rules governing FLI, and reasons to avoid boilerplate disclosure.

2. CBCA diversity disclosure guidelines

The regulator of federal corporations provided guidance on diversity disclosure in proxy circulars on February 3, 2021.

As we described last year, any "distributing"[1] CBCA company is required to disclose, in its circular or elsewhere, the number and percentage of board seats and senior management positions occupied by members of diverse groups, among other things. Specifically, it must provide data on women, Aboriginal peoples, persons with disabilities and members of visible minorities, and may disclose information about any other groups that contribute to diversity.

The new guidance is not substantive or binding, but sets out best practices for how the information should be presented. For example, in disclosing targets for future diversity levels, issuers should present the board and senior management figures separately and should indicate timeframes for each target.

The guidance also encourages the use of tables to present both targets and current figures on diversity, and sets out examples. Other recommended practices include, for any person who represents multiple designated groups, providing clarification to that effect in order to make the numbers transparent and comprehensible.

3. Advisory updates: ISS and Glass Lewis

Proxy advisors set out a number of new voting policies for 2021, with a (non-exclusive) focus on social and environmental matters.

A. Board gender diversity

Both ISS and Glass Lewis have updated their gender diversity policies for boards, in each case to take effect February 1, 2022.

There are three changes to ISS's gender policies, the first of which applies to members of the S&P/TSX Composite Index. Such companies will need to have either a minimum of 30 percent women on the board, or a formal written policy providing a commitment to achieve such threshold over a "reasonable timeframe."

The second ISS change is to remove, for all TSX-listed issuers, the "consideration given" to a company that does not meet board gender diversity levels, but has a better record among its executive officers.

Finally, the ISS exemption from the gender diversity rules will only apply to non-S&P/TSX Composite members. That rule exempts newly public companies, those that have recently graduated from the TSX Venture Exchange and companies with four or fewer directors.

Glass Lewis' new recommendation applies to all TSX-listed issuers. It currently requires at least one female board member, but will raise that to two for companies with seven or more directors. Glass Lewis allows wiggle room, however, for companies with "sufficient rationale or a plan to address the lack of diversity on the board."

1 This includes CBCA reporting issuers and any CBCA company that is listed on a stock exchange but not a reporting issuer in Canada.

B. Diversity other than gender

Neither Glass Lewis nor ISS has adopted a firm position on diversity levels, other than gender, among directors or management of Canadian issuers. Nor does either speak to targets for achieving a future level of diversity in, for example, board seats occupied by members of visible minority groups.

Glass Lewis addresses this issue obliquely, in reference to CBCA issuers, which are now required to make much broader diversity disclosure. Glass Lewis states that "poor disclosure" by such issuers in this area will prompt them to "hold responsible" the chair of the governance committee.

C. Environmental and social risk oversight

ISS has updated the examples of significant "failures of governance" that will cause a recommendation to vote against selected directors or the full board. The list now includes "demonstrably poor risk oversight of environmental and social issues, including climate change."

Glass Lewis has also highlighted its concern in this area, though its policy change only relates to the largest companies, being those in the S&P/TSX 60 Index, and is focused on disclosure rather than actual results. Starting in 2022, it will recommend voting against the governance chair of any S&P/TSX 60 company who "fails to provide explicit disclosure concerning the board's role in overseeing" environmental or social issues.

D. Exclusive forum proposals

This is a new area of formal recommendation for both main proxy advisors.

The ISS policy, applicable to companies listed on either the TSX or TSX Venture Exchange, codifies its existing approach of recommending to vote case-by-case on bylaw amendments that would adopt an "exclusive forum," or a single jurisdiction in which certain types of legal action – such as fiduciary duty claims – may be heard.

ISS advises that voting should be informed by the extent to which shareholders are potentially negatively impacted by the choice of forum, the extent of legal actions subject to the policy and the board's rationale for implementing the change.

Glass Lewis is similarly skeptical of exclusive forum proposals, but is more prescriptive. It has four conditions a company must satisfy to avoid a recommended vote against, being: (i) to demonstrate how the proposal would benefit shareholders; (ii) to show evidence of abuse of legal process in jurisdictions it wishes to avoid; (iii) to keep the proposal as narrow as possible; and (iv) having maintained good governance practices generally.

E. Other developments

Glass Lewis has also made adjustments to its policies and discussion on board skills composition, board refreshment, financial expertise, and continuation into a different jurisdiction.

II. Continuing developments

1. Climate risk disclosure

In our 2020 Proxy Guide, we described the CSA's policy statement on climate risk disclosure as it relates to MD&A and AIF disclosure. While Canadian securities regulators have made no further statements on the issue, it has gathered considerable attention in the media, in corporate and financial commentary and in civil society, and therefore warrants a re-examination.

The policy statement noted that institutional investors will be evaluating issuers based, in part, on their climate-risk disclosure.[2] This includes "physical risks" to an issuer's operations from acute events and chronic changes to the climate, as well as risks and opportunities related to the transition to a low-carbon economy.

One manifestation of this risk (and opportunity), is the Canadian government's recently announced plan to raise the national carbon-price floor to $170 in 2030, from $40 this year.

Other recent developments that have brought such risks into focus include the number and intensity of recent natural disasters that are linked to climate change, the related growing public awareness of the issue and the election of governments and administrations with a mandate to reduce carbon emissions.

The two main proxy advisors have made clear that they are focusing on this, as set out in I.3(c) above. Also relevant is messaging from investment titans such as Blackrock, whose CEO recently called for companies to disclose plans for "how their business model will be compatible with a net zero economy."

As we noted last year, climate risk should inform the preparation of MD&A and AIFs, where applicable risk disclosure is required.[3] In addition, integrating climate risk policies into board mandates is likely to be more important this year than before.

Resources for issuers in this area include publications of the Task Force on Climate-related Financial Disclosures, specifically its Guidance on Scenario Analysis for Non-Financial Companies. The Sustainability Accounting Standards Board provides detailed disclosure guidance and accounting metrics, by sector and industry.

2 CSA Staff Notice 51-358.

3 See the section 1.4(g) of Form 51-102F1 *Management's Discussion and Analysis,* and section 5.2 of Form 51-102F2 *Annual Information Form*.

2. Diversity on boards and in executive officer positions

Non-venture public companies have, since 2015, been encouraged to disclose the number of women directors and executive officers, and to make certain associated disclosures. As noted above, federally incorporated companies have more detailed diversity disclosure rules. There remains no quota system for gender or other diversity in Canadian companies, public or private.

The CSA typically provides an annual update on the number of women on boards and in executive officer positions. The 2020 report has been delayed until "early 2021," due to delayed AGMs by many companies on whose circular disclosure the data is based.

The rate of increase in gender diversity in recent years has been disappointingly low. In our view, this stems in part from how the disclosure rule is described. The requirements, set out in National Instrument 58-101F1, are widely known as a "comply-or-explain" model. This is misleading, in our view, since there are no benchmarks or targets (e.g. 30 percent women on the board) to comply with.[4] A similar point can be made of the CBCA diversity disclosure provisions.

The current regime is in fact, and should be known as, a *"disclose-or-explain"* model. This underscores that the only securities law requirements are to disclose the company's applicable policies and future plans, *if any*, or to explain why the company doesn't have such policies and/or plans.

In our view, significant progress in gender equity will be made easier if regulators and the legal and corporate community were to acknowledge and correct this fact. A "disclose-or-explain" regime connotes a half-hearted effort, which is borne out by recent data.

We note above the recommendation of proxy advisors that big companies should do more in this area. Notably, in its 2021 update, ISS identified 30 percent of women on a board as the right near-term target. A report from Ontario, discussed in Part IV below, recommends a 50-percent target. We think that a figure in this 30- to 50-percent range is likely to gain traction, and that it or a similar target should be applied to more than just senior issuers.

Of course, diversity in 2021 means more than just gender (and gender diversity should mean more than just focusing on women). Shifts in public opinion that followed acts of racial injustice in 2020 have increased pressure on issuers to have truly diverse boards and executives.

Data collected by the CBCA regulator, or the CSA, in respect of CBCA companies' diversity record will allow some analysis of the current diversity landscape.

We think it is likely that the CSA will also soon require disclosure on this basis, which will allow a broader assessment in the coming years. This will lay the groundwork for future benchmarks or quotas regarding ethnic and other diversity on boards and in executive officer positions for Canadian public companies.

4 A true comply-or-explain regime sets out rules or best practices and allows companies either to follow them or to explain why they are not doing so. The United Kingdom's Corporate Governance Code is an example. Public companies subject to the Code must either observe the rules and principles set out or explain, in public disclosure, why it is not doing so in any specific instance, together with background, rationale and timing of when it expects to comply.

III. Coming developments

1. Supply chain transparency

There has been progress on national supply chain transparency rules, including draft legislation in the Senate. Bill S-216 would enact the *Modern Slavery Act*, and is the third attempt to legislate in this area after two bills failed to pass in the previous Parliament.

The current proposal, which has an uncertain fate, would require entities to which it applies to make public an annual report on its practices in respect of forced and child labour. The report would have to detail steps the issuer has taken to reduce the risk of such practices in its supply chain, among other things.

Those subject to the legislation would include any entity that is listed on a Canadian exchange and that deals in goods; that is, an importer of goods into Canada or a producer or seller of goods anywhere.

Several other jurisdictions have implemented disclosure rules regarding forced labour in supply chains, including Australia, California, France and the UK.

Many Canadian companies have adopted supply chain codes of conduct. Some are required to do so, whether through operations in an adopting jurisdiction or as supplier to a company in such jurisdiction, and some have done so voluntarily.[5]

As a separate initiative, a federal prohibition on the import of goods produced by forced labour took effect in 2020. This effort, which has been highlighted in the government's response to alleged human rights abuses in the Chinese region of Xinjiang, seems to be a greater focus of federal supply-chain initiatives than Bill S-216.

2. CBCA changes not yet in effect

Several governance amendments to the CBCA have been enacted but are not in force. These changes – regarding majority voting, notice-and-access, mandatory say-on-pay, compensation claw-back and disclosure on well-being – were described in our 2020 proxy season update. All will require regulations, which will be preceded by public consultation.

Consultation on say-on-pay and compensation claw-back, among other things, are currently underway.

3. Coming regulatory developments

The CSA has not yet followed-up on its consultation on the "access equals delivery" model for certain disclosure documents that we described last year.

Regarding "SEDAR+", which also featured in our 2020 report, this is officially on track for a staged roll out beginning late this year. An update on timing, rollout and training is expected by the end of March 2021.

5 The Straight Goods – Canadian Business Insights on Modern Slavery in Supply Chains, May 2019.

IV. Possible future developments

1. Report of Ontario's Capital Markets Modernization Taskforce

This report recommended a number of changes to securities regulation in Ontario and, implicitly, the rest of the country.

Proposals that would, if acted on, impact future proxy seasons, include:

- Moving to an **access equals delivery** model for all disclosure documents (recommendation 20)
- Board and management **diversity targets** of 50 percent women and 30 percent other underrepresented groups for all listed issuers (recommendation 36.1)
- Regulating **proxy advisors**, such as ISS and Glass Lewis, including providing issuers with a right to rebut the advisors' reports (recommendation 38)
- **Board tenure** limit of 12 years, or 15 for the board chair, with some exceptions (36.3)
- Mandatory, non-binding **say-on-pay** for all listed issuers (recommendation 40)
- Allowing issuers to **access beneficial ownership** information, by removing the "OBO" and eventually the "NOBO" status for shareholders (recommendation 46)

Whether, when and how the report's recommendations are implemented is very much up in the air.

Regarding these proxy-related recommendations, the non-Ontario CSA members noted that they "may consider" the proposals relating to diversity, proxy advisors and accessing beneficial ownership. They poured cold water on mandatory say-on-pay, and were silent on access equals delivery and the board tenure limits.

A panel of the Ontario Securities Commission provided a separate submission, which endorsed the access equals delivery and proxy advisor proposals, and gave nonspecific support for increased board and management diversity. It did not speak to the other proxy-related matters.

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