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Share Authorization Requests in Canada: What's Required and What's Recommended

There are a number of parties that have influence over a company's share plan design as well as obtaining investor approval.

Seeking shareholder approval in Canada requires an issuer to navigate strict compliance with securities regulation as well as the guidelines and policies promulgated by major shareholders and their advisors.[1]

What follows is a brief summary of major requirements and considerations involved in seeking authorization for a new or amended equity compensation plan.

Securities Regulatory Compliance:

Ontario Securities Commission: Generally, a proxy circular must be provided, along with any notice of a shareholder meeting. The proxy must conform to the requirements of National Instruments 51-102F5 and 51-102F6, which set out the format for a proxy circular and the mandatory inclusion of a statement of executive compensation and information on securities authorized for issuance under equity compensation plans. The statement of executive compensation includes a required Compensation Discussion & Analysis (CD&A) and the disclosure of tabular and textual compensation data and information.

TSX listing requirements: Public issuers must also comply with the listing requirements of the Toronto Stock Exchange (TSX), which include the rules set out in the TSX Company Manual at section 613, "Security Based Compensation Arrangements."[2] Specifically, sections 613(d) and (g) contain disclosure requirements concerning specifics about the plan provisions that must be met prior to a meeting where shareholder approval of any security-based compensation arrangement is requested. These materials must also be pre-cleared with the TSX. Annual information must also be provided in the proxy circular concerning the terms of all share-based plans and any amendments to these plans as of the date of the proxy circular.

Shareholders and their Advisors:

Proxy Advisory Firms' Policies: Institutional investors have a fiduciary duty to act in the best interest of their beneficiaries. Voting the numerous shares in their custody has spawned a number of proxy advisory firms who provide voting recommendations for their clients. The Canadian Securities Administrators have approved National Policy 25-201 Guidance for Proxy Advisory Firms that is intended to provide non-prescriptive guidance to these firms. It contains guidelines on managing conflicts of interest and transparency. As in the United States, Institutional Shareholder Services (ISS) and Glass, Lewis & Co. dominate the proxy advisory services market in Canada.

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1. In Canada, if a share plan design provides (either in reality or theoretically) for the issuance of shares from the Treasury, then shareholder approval must be sought. There is a limited exception for grants made as an inducement to full-time employment that represent less than 2% of the issuer's outstanding, undiluted shares.

2. Note: TSX Venture issuers are subject to different requirements.

ISS and Glass Lewis' major concerns with executive compensation are outlined in published proxy voting guidelines[3] which set out both general concerns over pay governance and problematic pay practices as well as specific design requirements for share authorization requests. The table below details their positions.

Issue	ISS	Glass Lewis
General Approach	Vote against equity plan where criteria in the following areas are not met: ▪ Total cost of equity plans is unreasonable (Shareholder Value Transfer (SVT) model is used to determine reasonable plan cost against industry "caps") ▪ Dilution and burn rate are unreasonable (but only where cost of plan cannot be calculated due to lack of historical data) with dilution in excess of 10% on a non-diluted basis or burn rate for all company plans has been more than 2% ▪ Plan amendment provisions do not meet ISS guidelines ▪ Non-employee director participation is discretionary or unreasonable ▪ Disconnect between CEO pay and company performance, which is determined using a two-step process: 1. Quantitative screen that analyzes CEO pay against total shareholder return (TSR) on a relative and absolute basis 2. If the quantitative screen indicates misalignment then a qualitative analysis is performed that considers a range of factors (such as the ratio of performance-based vesting to time-based vesting awards; amount of performance-based compensation; and quality of disclosure) ▪ Plan is a vehicle for problematic pay practices	Evaluation of plans based on the following criteria: ▪ Shares only sought when required ▪ Plans with fixed numbers of shares should be small enough to require approval every three to four years ▪ Annual net share count and voting power dilution should be limited ▪ Cost of plan should be proportional to the value of the business and should deliver value on a per-employee basis when compared to plans at peer companies (a proprietary model is used to compare plans to a peer group and to model whether a plan is more than one standard deviation away from the peer average on a range of criteria) ▪ Plans should not contain excessively liberal administrative or payment terms and should be administered by independent directors ▪ Plans should not permit excessive payouts upon change of control

3. ISS 2015 Canada Proxy Voting Guidelines for TSX-Listed Companies and Glass Lewis Proxy Paper Guidelines: 2015 Proxy Season

Specific Approach for Full-Value Award Plans	N/A	Full-value plans should avoid: ▪ A limit of rolling 10% maximum (typical for stock option plans); a company should establish significantly lower limits for full-value plans or use “full-value award multipliers” to account for the higher cost ▪ The absence of performance conditions or vesting provisions ▪ Failure to disclose clear descriptions of performance measures and vesting schedules ▪ Non-executive director participation is at the same level as management ▪ Administration of the plan by non-independent members of the board ▪ Single-trigger change-in-control provisions
Specific Approach for Option Plans	Vote against the plan if it permits repricing of stock options and the company has repriced within the past three years	▪ Generally vote against option repricing proposals, but it may be appropriate in some circumstances (such as market or industry decline or new price and terms are reasonable) ▪ Plans should not permit option repricing without shareholder approval ▪ Maximum percentage of shares available for issuance should not exceed 10%

It’s important to note that in the United States, ISS has adopted a balanced scorecard approach to evaluating an equity plan proposal. Under this approach, rather than assigning a pass/fail to each consideration, positive factors in one area may outweigh negative factors in another (or vice-versa). If the plan's total score out of 100 on the scorecard is at least 53, then ISS will support the plan. Based on past practice, it is likely that this approach will be adopted in Canada in the near future.

Major Institutional Investor Guidelines/Requirements:

The Canadian Coalition for Good Governance is an association of institutional investors that serves to articulate a common set of best practices, including its Executive Compensation Principles (2013), which emphasize the following fundamental principles:

- Pay should be at risk and based on performance

- Performance should be based on key business metrics aligned with corporate strategy and the period during which risks are being assumed
- Executives should build equity to enhance alignment with shareholders
- A company can choose to offer pensions, benefits and change-of-control entitlements, but should ensure that they are not excessive
- Compensation should be simple and easily understood by management, the board, and shareholders
- Boards and shareholders should actively engage with each other and consider one another's perspective on compensation matters

Institutional investors and leading investment management firms also publish proxy voting guidelines, and mutual funds are required to publish the results of their votes. As noted in a 2013 study by the Responsible Investment Association, voting in favor of management recommendations on executive share-based compensation was by no means a reflexive activity: on average, 33% of votes were cast against management on resolutions for new or amended share plans.[4]

Next Steps

While complying with securities regulations and paying close attention to proxy advisory firms and institutional investor policies are critical to the implementation of any share-based compensation plan design, the Canadian landscape is also significantly shaped by Canadian tax rules. These include a 50% employee income tax deduction for qualifying stock options and prohibitions on corporate deductions associated with virtually all plans that settle in previously-unissued stock.[5] The potentially complicated interaction of the governance, securities and tax regimes is frequently overlooked. Often the result is that plan designs are compelling from one perspective but may have undesirable outcomes when factoring in other influences.

For more information about our services for share authorizations, visit radford.com/equity_share_requests. To learn more about participating in a Radford survey, please contact our team. To speak with a member of our compensation consulting group, please write to consulting@radford.com.

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4. Canadian Mutual Fund Proxy Voting Survey, June 16, 2014, Responsible Investment Association

5. Canadian tax rules provide employees who hold qualifying stock options with a 50% deduction from taxable income -- effectively mimicking capital gains treatment for employment income. However -- and without regard to any employee deduction -- no costs associated with previously-unissued shares can be deducted by a Canadian corporation.

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