2016 MODEL PROXY VOTING GUIDELINES

RESPONSIBLE INVESTMENT FOR A SUSTAINABLE ECONOMY

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Disclaimer: These guidelines are provided as a model for pension funds in developing their proxy voting policies and procedures. They are not to be taken as legal advice. Pension funds are strongly advised to seek independent legal and financial advice in developing their proxy voting procedures to best suit the interests of their plan members.

ABOUT SHARE

SHARE is a Canadian leader in responsible investment services, research and education for institutional investors. Since its creation in 2000, SHARE has carried out this mandate by providing active ownership services, including proxy voting and engagement, education, policy advocacy, and practical research on issues related to responsible investment. Our clients include pension funds, mutual funds, foundations, faith-based organizations and asset managers across Canada. SHARE's leadership on responsible investment is both national and international. SHARE is a signatory to the United Nations Principles for Responsible Investment (UN PRI) and a Global Reporting Initiative (GRI) Organizational Stakeholder. SHARE also coordinates the Secretariat of the Global Unions Committee on Workers Capital (CWC).

ABOUT THESE GUIDELINES

These guidelines have been developed by SHARE as a model for use by Canadian pension funds. The guidelines are written in the first person—"[the fund]"—to make them similar to guidelines that would be adopted by a board of trustees.

In addition to having a set of proxy voting guidelines, pension funds should ensure that plan documents provide the appropriate authority for trustees to execute or delegate the execution of their voting rights and that procedures for proper accountability are in place. For information about incorporating proxy voting policies into plan documents, please refer to the SHARE publication How to Incorporate Active Trustee Practices into Pension Plan Investment Policies. More information about proxy voting is available at www.share.ca.

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GENERAL PRINCIPLES

PROXY VOTING RESPONSIBILITIES

[The fund] manages its assets in a manner that will provide benefits to plan participants and their beneficiaries over a span of many decades. Consequently, [the fund's] actions must support these parties' long-term interests.

Equities held by [the fund] usually carry voting rights. Voting rights are valuable assets of [the fund]. Trustees have an obligation to ensure that shares owned by the plan are voted in a way that supports the interests of the plan's participants over the long term.

Duties of loyalty and care

The trustees of the fund and anyone appointed to vote proxies on the trustees' behalf have a duty of loyalty to exercise their proxy voting authority solely in the interests of the plan's participants and beneficiaries. They have a duty of care to exercise their proxy voting authority with the prudence, skill, and diligence that a prudent person would exercise in managing the property of others. Failing to vote the plan's shares, voting without consideration of the effects of the vote, or voting arbitrarily with or against management violates these duties. Those who are responsible for voting [the fund's] shares also have a duty to take reasonable steps to ensure that they receive and act on the proxies for all of [the fund's] shares in a timely manner.

APPLICATION OF THESE GUIDELINES

[The fund] will vote its proxies in accordance with these proxy voting guidelines.

In deciding how to apply the guidelines, [the fund] will consider the circumstances of each vote as well as the general principles contained in these guidelines. The overarching principle in interpreting and applying these guidelines is to follow the course of action that will best serve the long-term interests of plan participants and their beneficiaries. Voting decisions may deviate from these guidelines if doing so would best serve participants' interests in the long term. If questions arise about the application or interpretation of these guidelines for any issue, they should be resolved in consultation with [the fund's] trustees.

- [The fund] will vote in a manner that is consistent with the duties of loyalty and care, and that supports implementation of current best practices in corporate governance and social responsibility.
- Above all else, [the fund] will always vote in the best long-term interests of its participants and their beneficiaries.

[The fund] will not attempt to manage companies by shareholder referendum, and will ensure that any attempts to influence a company do not harm its financial viability.

RETENTION OF VOTING AUTHORITY

In cases where [the fund] delegates its voting authority to external investment managers or a proxy voting service, it reserves the right to direct the vote on any particular resolution or issue.

ANNUAL REVIEW OF GUIDELINES

The standards for corporate governance and corporate social responsibility evolve over time. There is growing acceptance of the view that shareholders' interests must be considered along with those of a company's other stake-

holders, such as its employees, creditors, suppliers, and the citizens of the community where it operates, as well as the environment, in order to sustain long term profitability.

This shift in the view of shareholders' role in the company is consistent with the perspective of long-term shareholders and with the inclusion of environmental, social and governance issues into investment decision-making. Corporate governance standards are evolving accordingly.

[The fund] will continue to monitor changes in corporate governance as these standards change and update these guidelines to reflect those changes. These guidelines will be reviewed, updated, and approved by [the fund's] investment committee on an annual basis.

INSTRUCTIONS FOR VOTING PROXIES

[We encourage funds to put their instructions or procedures for voting proxies in this section of the guidelines. Instructions and guidelines vary greatly from fund to fund, depending on the extent to which responsibility for proxy voting is delegated, and how and to whom it is delegated. For more information and guidance on proxy voting procedures see A Guide to Incorporating Active Trustee Practices into Statements of Investment Policies and Procedures at www.share.ca.]

Any investment manager or adviser who, under the terms of a contract, is responsible for voting shares held by [the fund] is expected to follow these proxy voting guidelines in making voting decisions. Where the guidelines call for decisions to be made on a case-by-case basis, voting agents should base their decisions on what would best serve the plan's participants in the long term. If a voting agent believes the interests of participants would be best served by deviating from the guidelines, [the fund's] trustees should be consulted before such a vote is cast.

REPORTING REQUIREMENTS AND TRANSPARENCY

[The fund] will make these guidelines available on request to all companies in which we invest, to any plan participant, and to the public. [The fund's] full voting record is available on our website and by request.

Where voting decisions have been delegated, trustees must monitor these voting decisions as part of their duty to manage the fund in the best interests of the plan members. The fiduciary responsible for voting should report regularly to the trustees on how he or she has voted each proxy. This report should include a written account of the reason [the fund] authorized any vote that deviates from these guidelines. [The fund]'s trustees and their voting fiduciary will agree on the details, timing, and frequency of these reports at the beginning of the fiduciary's contract, and they will review their agreement annually.

CORPORATE GOVERNANCE

GENERAL GUIDELINES

The standards for good corporate governance around the world tend to be more alike than are the legal requirements and norms for corporations in different countries. [The fund] will not ignore the laws and norms of the countries in which companies operate, but it has chosen to apply these guidelines consistently in all regimes, even when doing so may mean applying a higher standard for corporate governance than is customary or legally required. In those cases where [the fund] intends to address an issue that appears only in certain jurisdictions or to apply different standards based on jurisdiction, this is stated in the relevant guideline.

Good corporate governance is based on the relationships between a company's board of directors and supervisory board, its management, and it's other stakeholders, including its shareholders, employees, and the citizens of the countries where it operates. The board controls the company's assets and actions, and it is responsible for overseeing the work of management. Shareholders, as the providers of the company's equity capital, have an important role to play in the company's viability. They elect the board, and have other rights that give them a voice in certain aspects of the board's operations. The relationships among these bodies are key to a company's long-term success.

Amendments to articles of incorporation or articles of association

All major changes in a corporation should be submitted to a vote of the shareholders.

Proposals to amend a corporation's articles of incorporation or association are often made in response to changes in the rules, laws, or regulations affecting the corporation, such as changes in stock exchange listing rules. Most of these changes are technical or administrative matters that will not affect shareholders' interests. However, the wording of these amendments must be carefully considered because some small changes in the wording of an article can have a significant effect on corporate governance.

Management often combines multiple amendments into a single item to be voted on in the proxy ballot. This makes it impossible for shareholders to approve some amendments while voting against others. [The fund] encourages companies to give shareholders the opportunity to vote separately on all amendments. See the guideline "Omnibus or Linked Proposals," page 41.

- [The fund] will assess proposals to amend articles of incorporation or articles of association on a case-by-case basis, with primary consideration given to how they affect the company and its stakeholders in the long term.
- In cases where shareholders must vote on a group of amendments as one ballot item, [the fund] will vote against the entire group of amendments if it is opposed to any of the amendments.

Approval of second or casting votes

Some companies include in their bylaws a provision that allows the chair of the board or of a committee to cast the deciding vote on an issue if there is a tied vote at a meeting of shareholders, a board meeting, or committee meeting. This additional vote is called a casting vote or a second vote. [The fund] is opposed to this practice, because it gives the Chair of the board or committee one vote more than other directors or shareholders.

- [The fund] will vote against amendments to bylaws or articles if they include a provision for a casting vote or second vote to decide tied votes at the meetings of shareholders, the board, or board committees.

Approval of "other business"

Sometimes companies include the approval of "other business" as an item on the proxy ballot without specifying what the "other business" consists of. [The fund] believes that approval of such items gives the company broad discretion to act without specific shareholder approval on issues that would otherwise require such approval.

- [The fund] will vote against the approval of unspecified "other business."

Adjournment of a meeting to solicit votes

- Companies will sometimes ask shareholders for their approval to adjourn a shareholders' meeting to allow the company to solicit more votes in favour of one of its proposals. This usually occurs at special meetings when the proposal at issue is a merger or acquisition.

[The fund] is generally opposed to adjournments for this reason. Shareholders' votes become meaningless if the company can keep soliciting votes until it gets the outcome it wants. However, there may be circumstances in which it is reasonable for the company to make this request.

- [The fund] will vote against proposals to adjourn a meeting of shareholders for the purpose of allowing the company to solicit more votes in favour of its proposals, unless there is a compelling reason to vote for it.

Allocation of profits and/or dividends

Outside of North America, many companies must have the approval of their shareholders to allocate their profits between dividends, compensation for the directors and statutory auditors, and other uses.

The amount of dividend that is appropriate depends on the size, maturity, and profitability of a company. Companies that are large, mature and have a fairly consistent income should have a payout ratio of approximately 30%. [The fund] will approve these profit allocation proposals unless the dividend payout ratio is consistently low for size, maturity, and profitability of the company, and the company provides no explanation for the size of its dividends. [The fund] will also oppose dividends that are higher than the company's financial position warrants.

- When a company's proposed dividend is higher than the company's total annual profit, [the fund] will vote case by case, based on the company's ability to maintain sustainable operations.
- [The fund] will vote against dividend or profit allocations if the dividend payout ratio too small for the size, maturity and profitability of the company and the company has not provided an adequate explanation for the lower amount.
- [The fund] will vote against dividend or profit allocations if the dividends are too high to allow the company to continue to operate sustainably.

Scrip dividend alternative

Companies in some jurisdictions may give shareholders a choice of taking their dividend in additional shares instead of cash. This is called a scrip dividend. Scrip dividends allow the company to keep more of its cash in retained earnings, which may improve the value of the company in the long term. Scrip dividends may also give shareholders certain tax benefits. However, shareholders should be allowed to receive their dividend in cash if they prefer.

- [The fund] will vote for scrip dividend proposals as long as shareholders also have the option of receiving the dividend in cash.

Approval of the transfer or use of reserves

Normally, a company that pays dividends and has a financial loss in a given period will pay a lower dividend or withhold dividend payments for that period. However, some companies have a policy to make all dividends the same or nearly the same amount. This is called a stable dividend policy.

Companies with such a policy may use some of their reserves to pay the dividend, or, if shareholders approve, transfer reserve funds to other accounts in order to cover some of their losses. Shareholders should view this practice with caution. Using reserves to pay a dividend is not necessarily harmful if it is done infrequently. Companies may also set up special reserve funds for the purpose of paying dividends that do not affect their legal reserves. However, companies should not damage their long-term financial viability to pay a dividend. If a company is losing money regularly or losing substantial amounts, and if the losses are due to strategic management problems or an economic downturn, the use of reserves to pay dividends is not justified because it threatens to deplete the company's reserves.

- [The fund] will vote against proposals to transfer reserve funds or use reserves to pay dividends if financial losses have made this use of reserves necessary and the losses are regular, substantial or due to strategic problems within the company.
- [The fund] will vote against proposals to transfer reserve funds or use reserves to pay dividends if the company has also used reserves to pay dividends in both of the last two years.

Approval of legal formalities

These proposals ask shareholders to give management the authority to complete any formalities needed to validate the decisions made at shareholder meetings.

- [The fund] will vote for proposals to approve legal formalities.

CAPITAL STRUCTURE

Share issuances

(See also "Unequal Voting Shares and Dual Classes of Shares," pagepage 13.)

[The fund] recognizes that directors need the flexibility to issue shares to address a company's financial needs and conditions. However, it does not support giving directors unlimited discretion to increase the number of shares that may be issued without the consent of shareholders. In this context, the term "shares" refers to shares, share warrants, or bonds that can be converted into shares.

Some jurisdictions allow companies to issue unlimited numbers of shares. Often, this is a provision of the jurisdiction's corporate law or part of a company's charter, and shareholders do not have an opportunity to vote on it. However, if shareholders are given an opportunity to vote on an unlimited share issuance, [the fund] will vote against it.

Companies in some jurisdictions routinely place authorizations to issue shares on proxy ballots, regardless of whether or not the company intends to issue any new shares. In these cases, we will not take the frequency of a company's request for share issuances into consideration. Companies in other jurisdictions, including North America, only ask for the authorization to issue shares when they intend to issue shares or anticipate that they may need to do so. [The fund] will consider the frequency with which the company requests share issuances in determining how to vote on these requests.

Share issuances should be made at the market price for the shares at the time they are issued. However, shares issued at a discount and with pre-emptive rights can benefit shareholders and allow a company to raise capital quickly and inexpensively. In these cases, [the fund] will support issuances of discounted shares, as long as the issuance is open to all shareholders. It will oppose any other issuances of discounted shares.

- [The fund] will vote against proposals to issue shares where the potential aggregate dilution is more than 20%, unless the company provides an acceptable business case for issuing additional shares. This includes proposals to create authorized or conditional capital.
- [The fund] will vote against proposals to issue shares where the number of shares to be issued is not specified or is unlimited.
- [The fund] will vote against proposals to issue shares if the shares will be issued at a price that is less than the shares' market price at the time of issue, unless the shares have pre-emptive rights and the issuance is open to all shareholders.
- [The fund] will vote against share issuances that could be used as a takeover defence.

[The fund] may also vote against share issuance proposals if doing so is warranted by the reasons given for the requests.

Pre-emptive rights

Outside of North America, companies often issue shares with pre-emptive rights, which allow shareholders to share proportionally in any new issuances of shares in the same class as the shareholders already own. Pre-emptive rights make share issuances less dilutive for existing shareholders.

- [The fund] will vote for proposals to issue shares with pre-emptive rights if the potential aggregate dilution is 50% or less, or if the company provides a sound business reason for the issuance.
- [The fund] will vote against share issuances with pre-emptive rights if the amount of shares to be issued is not specified.

Waiving pre-emptive rights

Companies that issue shares with pre-emptive rights sometimes ask their shareholders to waive their pre-emptive rights. Share issuances without pre-emptive rights are more dilutive to existing shareholders than issuances with pre-emptive rights. [The fund] will vote for waiving pre-emptive rights, but only with a lower limit on the size of the issuance. Share issuances without pre-emptive rights must have the same limitations on dilution, authorizations, and price as share issuances without pre-emptive rights, which are described above.

- [The fund] will vote against proposals that ask shareholders to waive their pre-emptive rights if the company does not specify the number of shares affected.
- [The fund] will vote against proposals that ask shareholders to waive their pre-emptive rights if the number of shares constitutes more than 20% of share capital, unless the company gives a sound business reason for asking for a larger proportion.

- [The fund] will vote against proposals that ask shareholders to waive their pre-emptive rights if the shares without rights will be discounted below their market value at the time of issuance.

Under corporate governance standards in the UK, companies may increases the number of shares without pre-emptive rights, with shareholders' approval, by no more than 5%. Companies may ask their shareholders to approve an additional 5% increase but only if the additional shares are used for an acquisition or a specific capital investment. Unfortunately, at least one company has abused this by using the 10% increase in shares for other purposes.

- If a company in the UK asks for authority to increase its shares by 10% without pre-emptive rights, but uses more than 5% of that increase for a purpose other than an acquisition or specific capital investment, [the fund] will vote against the entire board at the next opportunity.

Issuances of blank-cheque preferred shares

Blank-cheque preferred shares give the board of directors broad discretion to determine the voting, dividend, conversion, and other rights of preferred shares. The board may also have discretion to determine the number of preferred shares to be issued.

[The fund] opposes the issuance of blank-cheque preferred shares because such shares give directors complete discretion over the conditions of the issuance and because they can be used to thwart a takeover bid without presenting the bid to shareholders.

- [The fund] will vote against the authorization of blank-cheque preferred shares.

Share buybacks or repurchases

Share repurchases tend to benefit shareholders in the short term, but they can be detrimental to companies in the long term. Share buybacks allow shareholders to sell their shares back to the company at a good price and usually raise the share price, at least for a short time.

However, repurchases also have undesirable consequences. The lift in share price that share repurchases provide is not based on improvements in the underlying performance of the company. In addition, the use of surplus cash to buy back shares can add to the volatility of the share price especially repurchases using derivatives. Share repurchases can also inflate the value of stock options, making that form of executive compensation more expensive to the company. Furthermore, if a company uses a per-share measure of executive performance, such as earnings per share, for determining executives' bonuses, share repurchases will inflate the company's per-share performance, thereby giving executives an unearned bonus.

Finally, many companies are spending substantial amounts of money to repurchase their shares. Between 2001 and 2012, each company in the Standard and Poor's 500 spent an average of US$600 million per year repurchasing its shares. Companies that spend large amounts to repurchase their shares are not using those funds to increase their productivity, develop better products, hire additional staff, or take other steps that would improve the company's performance in the long term.

European companies usually ask their shareholders for blanket authority to repurchase a percentage of the company's outstanding shares (often 10%), with upper and/or lower limits on prices. Companies may ask for blanket authorization to repurchase a set percentage of their shares as a takeover defence. These requests should be evaluated for their capacity to protect management at the expense of other stakeholders. Companies may also set a very high upper price limit for share repurchases, or not set an upper limit at all. Such proposals could effectively become an authorization to pay greenmail (see "Greenmail," page 12). The criteria for determining whether or not the repurchase price is too high depend on the context of the proposal. Thus, these votes must be assessed case by case.

In Japan, share buybacks may be used to undo the cross-shareholdings that have protected management against takeovers and efforts at corporate reform. In these cases, share repurchases benefit shareholders in the long term, regardless of the market conditions. However, the company should specify the number of shares or the monetary value of the shares it intends to repurchase, so that shareholders can estimate the likely effects of the proposal on their shares.

Japanese companies are permitted by law to amend their bylaws to allow share buybacks without shareholder approval. [The fund] is opposed to such amendments.

- [The fund] will assess share buybacks on a case-by-case basis for their effect on the long-term performance of the company and its stakeholders.
- [The fund] will vote against proposals to repurchase shares if the company uses per-share measures of executive performance in its executive compensation plans.
- [The fund] will vote against proposals to repurchase shares if the number of shares to be repurchased is more than 10% of the total shares outstanding or if the company does not specify the quantity of shares to be repurchased.

- [The fund] will vote against proposals to amend a company's bylaws to permit the company to repurchase its own shares without shareholder approval.
- [The fund] will vote against proposals to repurchase shares if the repurchases could be made using derivatives.

Reissue of repurchased shares

Some companies ask shareholders for authority to reissue shares that have been repurchased. This proposal is sometimes referred to as a share reissuance mandate. Companies may also seek to reissue repurchased shares through a general share issuance that includes authorization to reissue the repurchased shares.

Companies may seek to reissue repurchased shares to related parties at a discount. [The fund] is opposed to this practice. [The fund] will vote for proposals to reissue repurchased shares only if the shares will be reissued at their market price.

- [The fund] will vote against proposals to reissue repurchased shares unless the proposal stipulates that the shares will be reissued at their market price.

Proposals to reissue shares will also be subject to the same voting guidelines as other share issuances, including limits on the percent of share capital that can be issued. See "Share Issuances," page 11.

Stock splits and reverse stock splits

Companies usually propose to split their stock when the stock price is high and the company wants to make its shares more affordable. Stock splits increase a share's liquidity. This usually benefits shareholders, as long as all shareholders are treated equally and the split does not result in any additional benefits to company insiders.

Reverse stock splits can be more complicated. Companies often propose them when the price of their shares has fallen. Thus reverse stock splits can indicate that a company is having problems that are driving down the value of its shares, which is always a concern for investors. Also, because reverse stock splits lower the number of shares a company has, they can increase executive compensation based on any financial indicator that is measured per share (such as earnings per share).

- [The fund] will decide how to vote on stock splits and reverse stock splits case by case.

Unequal voting shares and dual classes of shares

Common stock traditionally carries one vote per share. Companies with dual-class share structures or shares with multiple voting rights have a class or classes of shares with more than one vote per share. Dual-class share structures allow some shareholders to maintain control of the corporation without holding an equivalent amount of equity.

France automatically grants two votes per share to shareholders who own shares for two years or longer, unless the company opts out of this arrangement. These "loyalty shares" promote long term shareholding, but they violate the principle of one vote per share and give some shareholders voting rights that are not proportional to their investment in the company.

[The fund] is opposed to unequal voting rights in most cases, for several reasons. First, they violate the principle of one share, one vote, making it possible for the company to act without the support of a true majority of shareholders. Second, when shares with multiple voting rights are initiated, they are likely to dilute the voting power of shares already issued. Third, it is not in the best interests of the majority of shareholders for one investor or a group of investors to control the corporation without a corresponding financial stake in the company. Finally, companies with dual classes of shares tend to be less profitable in the long term than companies whose shares have equal voting rights.[1]

Dual class share structures may be appropriate for new companies that need protection from hostile takeovers or from pressure to produce short-term profits. But these circumstances are exceptional. In these cases the dual class share structure should be eliminated once the company is well-established.

- [The fund] will vote against the creation, issuance, or continuation of capital structures with common shares that carry unequal voting rights.
- [The fund] will vote for the replacement of multiple-vote shares with shares carrying one vote per share unless the terms of conversion are more detrimental to the interests of the holders of subordinate voting shares than the continuation of the dual-class structure.
- For companies where a dual-class structure is already established, [the fund] will vote for proposals for a mandatory review of the share structure and regular re-approval by holders of subordinate voting shares.
- [The fund] will vote for proposals to opt out of "loyalty share" programs that give longer-term shareholders more than one vote per share.

BOARDS OF DIRECTORS

There are two broad types of corporate board structures. Some companies have a unitary board structure, also known as the Anglo-American model. This consists of a single board of directors that is responsible for overseeing the management of the company on behalf of its shareholders.

Other companies have two boards. The role and makeup of the boards at dual-board companies varies with the jurisdiction. In some jurisdictions (for example, Japan, Spain and Brazil), companies have a board of directors similar to the board of a unitary company, and a second board of statutory auditors. The statutory auditors are formally responsible for ensuring that the company's acts are legal and/or that the annual audit is properly conducted. Companies in other jurisdictions (such as Germany) are governed by a board of supervisors that includes employees' representatives, and a management board. The board of supervisors chooses the management board, which includes the executive officers and is responsible for running the company.

The guidelines below are applicable to all of these types of boards.

The role of director is becoming more complex, and the field of corporate governance has rapidly expanded to include areas where directors often have little background. Even knowledgeable directors may find that they need additional training in order to guide the company effectively. [The fund] supports director participation in training programs to improve their performance and the performance of the company.

Voting for directors

(See also "Independent Board of Directors," page 14, and "Independent Nominating Committee," page 17.)

- [The fund] will vote for directors case by case, taking into consideration these guidelines and the long-term performance of the corporation and the directors. The following are reasons, in addition to those listed in the following sections, for [the fund] to vote against management's nominees:
- The board of directors has consistently not acted on issues that have the support of a majority of shareholders or given an appropriate response to shareholders' concerns. This includes management proposals that a majority of shareholders vote against.
- The board of directors has taken steps to limit shareholders' rights without shareholders' approval, such as by adopting an exclusive form requirement without a shareholders' vote.
- The board of directors consistently acts in the interests of a group of shareholders rather than in the interests of all shareholders.
- An individual director is not qualified to be a corporate director, or the company has not disclosed adequate information about the director's qualifications.
- An individual director has a conflict of interest; a conviction for financial, corporate, or securities crime, including insider trading; or a history of serious misconduct, regulatory sanctions, or ethical violations relating to corporate responsibilities.
- There is evidence that directors have purposely misstated or concealed the financial condition of the company.
- The board has regularly demonstrated a lack of duty of care, such as approving corporate restructurings that are not in the shareholders' best interests or refusing to provide information to which shareholders are entitled.
- An individual director has served on the board of another company that has demonstrated a particularly egregious failure in its duty of care.

[The fund] might vote against a nominee for director for many other reasons. These are addressed in the following sections.

As demands grow for companies to operate sustainably, board may find that they need directors who have expertise in areas where expertise was not needed traditionally, such as in environmental matters or in human rights.

- [The fund] will vote for proposals to add directors to corporate boards who have expertise in areas that the board needs and/or lacks, such as environmental expertise, provided that the proposal is reasonable and directors who are nominated are well-qualified to be corporate directors.

Independent boards of directors

At companies with a unitary board, the company's management is accountable to the board of directors for how it runs the company. The board of directors is responsible for overseeing management's performance in a way that ensures the long-term, sustainable growth of the company. The board is accountable to the shareholders as owners of the corporation.

Directors have a legal obligation to act in the best interests of the company. However, it is difficult for anyone to

avoid being influenced by conflicts of interest. This is why boards of directors must as a whole be independent of the company's management. Directors are not in a good position to hold management accountable if they have a relationship to the company other than as shareholders and directors.

Two-thirds of the directors on a board should be independent, as defined in the next section.

- [The fund] will vote for proposals to require two-thirds of directors to be independent.
- [The fund] will vote for proposals that increase the number of independent directors on the board, unless two-thirds of the directors are already independent. If two-thirds of the directors are already independent, [the fund] will determine how to vote on each case individually, based on how the proposal will affect the company in the long term.
- If less than two-thirds of directors are independent, [the fund] will vote against the directors who are not independent.

It is often difficult for shareholders to determine whether or not a director is independent. Companies should disclose annually which directors are independent as well as details about the information used to make that determination.

- [The fund] will vote for proposals to require annual disclosure of which directors are independent and the basis on which the assessment was made.
- [The fund] will vote against a director if the company does not provide enough information for shareholders to determine whether or not that director is independent.

Definition of an independent director

It is difficult for shareholders to evaluate the independence of directors. Shareholders are not present at the board's meetings and do not know the directors personally. The information about the directors provided to them by the company does not necessarily tell them how easy it is for individual directors to make decisions without being unduly influenced by management or unduly pressured by other, non-independent directors. Thus, shareholders must rely on less-than-ideal information from the company to assess how likely it is that a director can make independent decisions about the company and its management.

If a director might appear not to be independent based on the biographical information provided to shareholders, but the company believes that director is independent, it should provide shareholders with an explanation of why it believes the director is independent.

In general, a director is independent if he or she has no material relationship with the company other than that of director and shareholder. This excludes any director who

- is currently or has been previously employed by the corporation, an affiliate of the corporation, or a company that has acquired by the corporation within the past 5 years;
- founded the company, individually or with others, if that person also maintains another relationship with the company, such as any of the relationships listed here;
- holds any contract, agreement or arrangement with the company that pays the director any compensation or benefits, other than the payments that person receives as a shareholder and a director (e.g. dividends and director's fees);
- is currently employed, or has been employed within the last three years, by the company's auditor;
- is employed by or owns a significant portion of an entity that does business with the company or has an immediate family member who does business with the company, including advisors, consultants, accountants, lawyers, banks, customers or suppliers. However, exceptions should be made for monopolies, such as utility companies, or very large companies that do business with many customers, such as very large banks;
- has, within the past five years, been an employee or owner of an entity that does business with the company, as described above;
- serves as a director on the board of a company that has an executive who serves on the board of the director's own company—a situation known as an interlocking directorship;
- is an immediate family member of any of the corporation's executives or management employees;
- is indebted to the corporation or any subsidiary, except for bank directors with a residential mortgage from their institution with the same conditions and rates provided to other customers;
- is employed by any organization, including a university or research institute, that receives financial support from the company or has some other close relationship with the company;
- owns an equity interest in, has extended credit to, or has an immediate family member who owns an equity interest in or has extended credit to an entity over which the corporation or any executive officer of the

corporation exercises significant control (significant control should be defined with reference to the contractual and governance arrangements between the corporation or executive officer and the entity);

- has provided, or has an immediate family member who has provided, any professional services to any executive officer of the corporation in the last five years; or
- has any other relationship similar in scope and nature to any of the relationships listed above.

Shareholders who hold a significant interest in the company or are affiliated with or designated by a shareholder with a significant interest may also be considered not to be independent. This includes shareholders who hold less than 50% of the company's voting power if they also have business transactions with the company or a relationship to management. The determination of these shareholders' or directors' independence will be made case by case. The determination will be based on whose interests the shareholder or director is mostly likely to represent, and on whether or not the director or shareholder would have any potential conflicts of interest in serving on the board.

Independent chair of the board

The chair of the board of directors must be an independent director, as defined above, in order to guide the board in its responsibility for overseeing management's performance. This is a basic tenet of good corporate governance. No one can fulfill the responsibilities of chair and those of a senior management position without potential conflicts of interest.[2] This provision includes the president–directeurs general of French companies, because they are effectively both CEO and board chair.

- [The fund] will withhold votes from directors who are not independent if they are also chair of the board or if, upon becoming director, they would become chair of the board.
- [The fund] will vote for proposals to require the chair of the board to be an independent director.

Independent lead directors

Some companies whose board chairs are not independent have sought to address concerns about that arrangement by appointing an independent lead director. However, it is extremely difficult for shareholders to know how much of the chair's job a lead director has assumed, or to what extent the person who still holds the title of chair actually runs the board.

Studies have shown that companies where the board is chaired by an independent director perform better than companies where the chair is an executive of the company, even if those companies have lead directors.[3]

[The fund] believes that the appointment of an independent lead director may be suitable as an interim step toward making the board's chair an independent director, but it is not a substitute for an independent chair. If a company chooses to appoint an independent lead director as an interim position, that person should serve as lead director for no longer than one year before an independent chair is appointed.

- [The fund] will not withhold its vote from the chair and CEO of a company if the board has a lead director who is independent (according to the definition in these guidelines) and the position of lead director will exist for no longer than one year, or if there is another compelling reason to accept a lead director in place of an independent board chair.
- [The fund] will vote for proposals to create an independent lead director position as long as the position exists for no longer than one year.

Key board committees

All boards of directors should have audit, compensation, and nominating committees made up entirely of independent directors. These committees are essential in overseeing a company. They are also in the best position to prevent corporate malfeasance and protect the value of the company.[4]

Japanese companies have traditionally not had board committees. However, legislation passed in 2002 encourages Japanese boards of directors to have compensation, nominating, and audit committees with independent members. In Germany, supervisory boards often have committees. These are discussed in the section on supervisory boards.

Independent audit committee

A board of directors should have an audit committee that is responsible for oversight of the annual external audit of the corporation. This is required by American and Canadian securities law. All members of the audit committee should be independent directors. The committee members should be free of ties to the company's auditor, including employment with the audit firm within the last three years.

Members of the audit committee need to be financially literate in order to oversee the complexities of the annual audit and to deal with the technical aspects of financial information.

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- [The fund] will vote for proposals to create audit committees in which all of the members are independent.
- [The fund] will withhold its votes from individual directors who are not independent and who sit on the audit committee.

Independent compensation committee

Every board should have a compensation committee that is responsible for the direction and oversight of the company's executive compensation program and for regularly evaluating the performance of senior management. In order to be effective and avoid conflicts of interest, this committee must be made up entirely of independent directors. Directors who are executive officers of other companies should not sit on the committee unless those companies are privately held and very small, such as a company with no more than two or three employees. Members of this committee should not be nominated or selected by management.

If a company's compensation committee includes members who are not independent, [the fund] will give special scrutiny to the company's compensation plans. It may vote against the plans if it believes the committee's lack of independence is influencing the company's executive compensation.

- [The fund] will vote for proposals to create independent compensation committees.
- [The fund] will withhold votes for individual directors who sit on the compensation committee and are not independent of management.
- [The fund] will withhold votes for individual directors who sit on the compensation committee if they are executive officers of other companies, unless those companies are privately held and very small.
- [The fund] may vote against a compensation plan if the compensation committee includes directors who are not independent.

Independent nominating committee

Boards should have a nominating committee to identify the need for directors and to recruit, nominate, and orient new directors. In order for the board to function independently of management, the nominating committee must be made up entirely of independent directors.

- [The fund] will vote for proposals to create nominating committees made up entirely of independent directors.
- [The fund] will withhold votes from directors who sit on the nominating committee and are not independent.

Corporate governance committee

A large board of directors should have a corporate governance committee responsible for overseeing the governance of the corporation. This committee should be able to function independently of management. A majority of the members should be independent directors.

- [The fund] will vote for the creation of an independent corporate governance committee.

Statutory auditors

In some jurisdictions, a board of statutory auditors is responsible for ensuring that the company's actions comply with all applicable laws. All Japanese companies are required to have a board of statutory auditors unless their board of directors has compensation, nominating, and audit committees. The board must contain at least three statutory auditors, who are usually elected to three- or four-year terms.

In practice, the role of statutory auditors may be ceremonial, although they are officially responsible for reviewing the work of the company's outside auditor.

Statutory auditors may not be independent. Even when "outsider" statutory auditors are nominated, they may still have close ties to the company. However, many companies are under pressure from international investors to change this practice. [The fund] supports efforts to make boards of statutory auditors independent of management.

Companies incorporated in Brazil have a structure similar to a board of statutory auditors, called a fiscal board or fiscal council. The fiscal council has oversight responsibilities similar to those of statutory auditors. They must have between three and five members, with an equal number of alternates. Brazilian corporate law requires that members of fiscal councils must be independent of management, must not also serve as directors of a company, and must not be relatives of any member of management or director.

- [The fund] will vote against statutory auditors who are not independent according to the criteria for independent directors given above.
- [The fund] will vote against statutory auditors or members of a fiscal council if there are serious questions or concerns about the company's annual audits, such as evidence that the auditor's independence has been compromised or frequent restatements of financial reports.

Supervisory boards

Supervisory boards are most common at German companies, but they can also be found in other jurisdictions. Under German law, companies are accountable first to their employees and creditors and second to their shareholders. The structure of supervisory boards reflects this; their members may be appointed by employees or elected by shareholders. The chair of the supervisory board is typically a shareholder representative.

The supervisory board is responsible for appointing, removing, and overseeing the company's management board, which is made up of executive directors and manages the company. The supervisory board is not involved in the day-to-day management of the company, but the supervisory board's approval may be required for decisions that would substantially affect the company's financial position or results. Members of a supervisory board cannot serve on the management board, and vice versa.

The presence of so many employees on the supervisory board means that these boards cannot have the degree of independence, as we have defined it, that [the fund] prefers on boards of directors.[5] German corporate governance includes measures to mitigate potential conflicts of interest on supervisory boards. Supervisory board members cannot, by law, provide any other services to the company without the approval of the board. Germany's Corporate Governance Code recommends that nominating committees take potential conflicts into account when selecting supervisory board nominees, and that any board member who has a conflict of interest during his or her tenure be removed from the board. The code also recommends that supervisory boards include no more than two former members of the management board, and that former management board chairs should not be chair of the supervisory board or any of its committees.

Companies in some other jurisdictions also have supervisory boards. Some of these boards have employee representatives and function much like the boards of German companies. Other supervisory boards do not have employee representatives. These supervisory boards should meet the same criteria for board independence that applies to unitary boards of directors, as described in the section "Independent Boards of Directors," page 14.

- At companies where the supervisory board includes worker representatives, [the fund] will vote for members of supervisory boards unless:
- more than two members of the board are former members of the management board;
- the candidate is a former member of the management board and is or would be the chair of a supervisory board committee;
- the candidate has a potential conflict of interest; or
- voting for the candidate would not, for some other reason, be in the best interests of the company.

Committees of supervisory boards

Supervisory boards should have audit, compensation and nominating committees. No former members of a company's management board should sit on its audit committee. German supervisory boards are also required to have a mediation committee to resolve any disputes within the board that may arise from the appointment or dismissal of management board members.

- [The fund] will vote for the creation of audit, compensation, and nominating committees on supervisory boards provided that these committees are not chaired by former members of the management board or by members who have potential conflicts of interest.
- [The fund] will vote against members of the supervisory board if they are former members of the management board and serve on the audit committee.

Shareholder nominations for director

[The fund] supports giving shareholders the right to nominate directors provided that the nominees are well-qualified and prepared to act in the interests of all shareholders. Shareholders have access to the proxy ballot in some jurisdictions, including Canada.

In order to nominate directors, a shareholder or group of shareholders should be required to hold enough shares to have a meaningful stake in the company, but not so many as to be prohibitive for most shareholders. The exact proportion will depend on the size of the company. For mid-sized companies, between 3% and 5% of ordinary shares is a reasonable amount.

Companies may restrict the number of directors that shareholders may nominate in order to prevent a shareholder from taking over the company by taking over the board. However, shareholders should be permitted to nominate no less than one-fourth of the board seats.

Shareholders who nominate a candidate for director should provide the same information about their candidate's qualifications, independence, and potential conflicts of interest as boards provide for their nominees. Nominations should be provided to the company in time to include

candidate information in the company's proxy information circular and on the proxy ballot. For companies in Canada, the usual time period is 30 to 65 days before the shareholders' meeting.

Canadian proxy access rules treat shareholders' nominations for directors like shareholder proposals. Shareholders get limited space in the proxy circular to present their nominees, and the nominations are often in an appendix at the end of the circular instead of in the body of the circular with the board's nominees. [The fund] supports giving equal treatment to all nominees to the board.

- [The fund] will vote for proposals to allow shareholders to nominate directors if they include an ownership threshold that is reasonable given the number of shares outstanding, and a requirement that nominating shareholders should provide adequate information to other shareholders about their candidate's qualifications and independence.
- [The fund] will vote for proposals to give equal treatment in proxy materials to shareholders' and board nominees for director.

Advance notice requirements

Recently, many Canadian companies have adopted advance notice requirements that set out time limits for submitting director nominations to the company, and other rules for shareholders who wish to nominate directors. These requirements are acceptable as long as they do not unnecessarily limit shareholders' right to nominate directors.

Advance notice requirements should not set time limits for submitting nominations and related information to the company that are unreasonable. If the notice of a meeting is published 50 days or more before the meeting date, the deadline should be no more than 30 days before the meeting. If the notice is published less than 50 days, the deadline for submitting shareholders' nominations should be no less than 10 days after the notice, or 15 days for a special meeting. There is no reason to set a maximum number of days before a meeting for shareholders to submit their nominations. If a meeting is adjourned or rescheduled, shareholders should not be required to resubmit their nominations and required other information.

Advance notice requirements should not require shareholders' nominees to agree in advance to comply with all of the company's policies and guidelines, because this may restrict the directors' ability to promote meaningful changes in the company. Shareholders should be not required to provide more information about their nominees than would be required in a dissident's proxy circular, or more information than is needed for shareholders to evaluate the nominees' qualifications and independence. The requirements should allow information about shareholders' nominees to be included in the company's proxy materials and appear on the company's proxy ballot.

Advance notice requirements must be approved by shareholders before being adopted.

- [The fund] will vote against the board of directors of a company that adopts advance notice requirements without the approval of shareholders.
- [The fund] will vote case by case on advance notice requirements, based on the reasonableness of those requirements. Reasons to vote against these requirements include
- an unreasonable time period for shareholders to notify the company of their nominations and provide the necessary information, as described above;
- a requirement that shareholders' nominees agree in advance to comply with all of the company's policies and guidelines;
- requirements that shareholders submit information about their nominations in excess of what is required for dissident proxy circulars;
- provisions that require shareholders to resubmit their nominations if the company adjourns or reschedules a shareholders' meeting.
- [The fund] will vote against advance notice requirements if the company does not indicate that information about shareholders' nominees will be included in the company's proxy materials and the nominees will appear on the company's proxy ballot.

Majority vote for elections of directors

(See also "Cumulative Voting," page 21)

Until recently, elections for directors at most Canadian companies and many North American companies were "plurality" elections. In practice, this means that a director needed only one vote in his or her favour to be elected. In addition, shareholders of most Canadian companies cannot vote against directors. Proxy ballots only allow shareholders to vote "for" or "withhold" for director nominees. The result is that unless a nominee receives no votes, all directors who are nominated are elected regardless of how many "withhold" votes they receive.

The Toronto Stock Exchange requires all listed companies to hold majority elections for directors.[6] Majority elections

require a director to win a majority of the votes cast in order to be elected to the board. They effectively turn "withhold" votes into votes against a nominee and make it possible for shareholders to remove a director from the board. [The fund] supports majority elections of directors because they allow shareholders to elect directors, rather than simply confirming the choices of the board.

In a variant of majority elections for directors, directors who do not win a majority of shareholders' votes must submit their resignations to the board, which then decides whether or not to accept the resignations. Many companies have substituted director resignation policies for true majority elections of directors. Director resignation policies are a second choice. They are an improvement over plurality elections, but they still allow the directors to determine who sits on the board instead of giving that power to the shareholders. These policies can also allow directors to remain on the board even after a majority of shareholders have voted to remove them. If a majority of shareholders vote for a proposal to implement majority elections, [the fund] will not consider the adoption of director resignation policies to be an adequate substitute.

- [The fund] will vote for proposals to require that directors receive a majority of affirmative votes to be elected.
- [The fund] will vote for proposals to require directors who do not receive a majority of affirmative votes to tender their resignations to the board, unless [the fund] has the opportunity to vote for majority elections instead.
- [The fund] will vote for proposals to require boards to accept the resignations of directors who do not receive a majority of affirmative votes of shareholders.
- If a board does not accept the resignation of a director who fails to win a majority of shareholders' votes, [the fund] will vote against the entire board at the next opportunity. [The fund] will make exceptions to this guideline if the company makes a compelling case for retaining the director.

Elections for individual directors

Although it is no longer common practice, some companies present their nominees for director as a slate. Shareholders must vote for or against the entire slate rather than vote for each director individually. This practice protects directors whose performance is unsatisfactory, because shareholders are less likely to vote against an entire board than they would be to withhold votes from individual directors. [The fund] prefers to vote for each director nominee individually.

- [The fund] will vote for proposals to allow shareholders to cast individual votes for each director nominee.

Contested elections for directors

When an election for directors is contested, the dissident candidates usually want to make a significant change in corporate policy. In deciding how to vote in contested elections, [the fund] will assess how any policy changes advocated by the dissident candidates will affect the long-term interests of shareholders. Dissident candidates must also be suitably qualified and independent.

Dissident slates of directors will be given special consideration when the corporation's performance has been inferior to its peers for two years or more, there are reasonable doubts that the current board can improve the situation, and the dissident director nominees have the qualifications and a business plan to improve the corporation's performance.

- In contested elections, [the fund] will assess votes for directors case by case, using the criteria in this section and all of the other relevant sections of these guidelines.

Term limits for directors

Directors must remain open to new ideas and be willing to re-examine the status quo, but must also maintain continuity and focus on the long term. Term limits for directors are used to increase the likelihood that the board will remain open to new ideas and will not become entrenched in the status quo.

However, term limits do not guarantee that directors will have this openness, and they can force valuable, experienced directors to leave the board solely because of length of service. They impose an arbitrary limit on directors' tenure regardless of performance, and they tend to inhibit a long-term view of a company's performance.

There may be instances in which term limits are in the best long-term interests of shareholders, and [the fund] will support term limits in those cases.

- [The fund] will vote against term limits for directors unless circumstances are such that they are in the long-term interests of shareholders.

Directors' ability to devote sufficient time and energy: Attendance

Candidates for director must be able to devote a sufficient amount of time and energy to the board in order to oversee the corporation well. [The fund] does not vote against directors who sit on more than a fixed number of boards; the number of boards a director can serve on effectively depends on that individual's abilities and commitments. However, a director's other commitments, attendance at board meetings, and overall performance as a director can be indicators of his or her ability to serve effectively.

Attendance at board meetings is not the sole determinant of a director's performance, but poor attendance makes it difficult for a director to fulfill his or her responsibilities to the board. Since boards customarily schedule their routine meetings and committee meetings at least a year in advance, anyone who agrees to be nominated for director should be prepared to attend all board meetings.

- [The fund] will withhold votes for directors who appear to have too many existing commitments to fulfill their duties as director. Indications that a director has too many commitments could include serving on more than five other boards and/or employment as a senior officer at another company.
- [The fund] will withhold votes for existing directors if they have missed 25% or more of the board's meetings and committee meetings, unless extenuating circumstances are set out in the proxy materials.
- [The fund] will vote for proposals to require companies to disclose directors' attendance at meetings.

Diversity on boards of directors

In order to foster the long-term success of corporations, boards should recruit directors with diverse backgrounds.

A diverse board of directors can challenge assumptions and bring a range of perspectives to address strategic challenges. Many studies of corporate performance have found that companies with diverse boards of directors and senior executive do a better job of creating long-term value than companies without this diversity.[7] Currently, there are groups that are under-represented on boards of directors in Canada. In 2015, 51% of the companies listed on the Toronto Stock Exchange had no women on their boards.[8] In 2014, 17.1 2% of board seats were held by women, 2% filled by visible minorities and .8% by aboriginal people.[9]

Companies should disclose their approach to diversity. Without this, it is difficult for shareholders to know how the nominating committee incorporates diversity into the recruitment process, if at all. Diversity should be defined broadly and can include age, professional experience, gender, race, linguistic and cultural background, sexual orientation/identification and disability.[10]

In 2014, most reporting jurisdictions in Canada passed regulations requiring issuers to disclose their policies in relation to on board renewal and gender diversity. Issuers must also disclose the numbers and percentages of women on their boards and in executive positions, their targets for increasing those numbers, and their methods for adding new board members. The new regulations are on a "comply or explain" basis. That is, the companies covered by the regulation are not mandated to have policies and targets, but if they do not, they must explain why.[11]

There is no one-size-fits-all diversity policy, but not all policies are equally acceptable. Good policies are those that, if implemented, will result in a more diverse board. This excludes policies that say the board relies solely on merit to select nominees without regard to diversity, and those that reject arguments in favour of greater diversity on corporate boards.

If a board is made up of only one gender or has no members of under-represented groups, an acceptable diversity policy should also acknowledge that the board needs greater diversity and explain what the board is doing to achieve it.

- If a company's board has no women and either does not disclose its policy on diversity, or discloses a policy that is not adequate as defined above, [the fund] will vote against the nominating committee of the board.
- [The fund] will vote for reasonable proposals that promote greater diversity on boards of directors.

Classified boards/staggered terms for directors

On a classified or staggered board, directors are elected for a term longer than one year, and their terms are staggered so that only a portion of the directors come up for election each year. Typically, one-third of the board is elected each year for a three-year term. The Toronto Stock Exchange does not allow listed companies to have classified boards, but classified boards are common in other jurisdictions.

[The fund] opposes classified boards. Classified boards can provide for continuity on a board. However, most boards of directors have relatively little turnover from year to year, even without staggered terms. In addition, classified boards reduce corporate accountability to shareholders and make it unnecessarily difficult to change control of a board.

- [The fund] will vote against proposals to adopt a classified board of directors.
- [The fund] will vote for proposals to eliminate classified boards and institute annual elections of all directors.

Cumulative voting

Cumulative voting for directors gives each shareholder as many votes as he or she has shares, multiplied by the number of directors to be elected. Shareholders may cast all of their votes for one candidate or distribute them among any combination of candidates. This makes it easier for a minority of shareholders to elect director nominees of their choice to

the board, enhancing the power of minority shareholders to influence the board.

The value of cumulative voting depends on the nature of the company. At companies where an individual shareholder or a small group of shareholders controls the majority of the votes, cumulative voting makes it easier for the holders of minority voting rights to have representation on the board. Cumulative voting may also help a previously unresponsive board to be more alert to shareholders' interests and concerns. In other circumstances, cumulative voting may give a minority of shareholders disproportionate control over the board, which violates fundamental principles of fairness and shareholder equality.

- [The fund] will vote on proposals to adopt cumulative voting case by case. In deciding how to vote, [the fund] will consider whether or not the company has a controlling or dominant shareholder or shareholder group, the board's responsiveness to the interests of all shareholders, and the quality of the company's corporate governance.

Cumulative voting and majority elections for director

As majority voting for directors becomes more common, there has been some debate about whether or not companies that have cumulative voting in elections for directors should adopt majority voting. Some experts on corporate governance argue that majority elections are incompatible with cumulative voting. Others claim that the two complement and enhance each other.

The combination of cumulative voting and majority elections for directors decreases each director's chances of being elected. However, if companies have a procedure for addressing vacancies on their board, this is not a serious problem.

- [The fund] will vote for majority elections at companies with cumulative voting unless the company does not have a procedure in place to address board vacancies that may result.

Size of boards of directors

The number of directors on a board is a factor in the board's effectiveness. A board needs enough directors to maintain diversity in opinion and expertise, but not so many that the board becomes unwieldy, or that individual directors lose the opportunity to be heard. In general, a good size for a board is 5 to 15 directors. It is rare for a board to function well with more than 21 directors. However, the appropriate number of directors will vary with the size and nature of the corporation. [The fund] prefers boards with odd numbers of directors, because they are less likely to have tied votes.

Fixing the number of directors can limit the flexibility companies may need to alter the size of their boards as they change. Companies that need to add independent directors or improve the diversity of their boards may also need this flexibility. However, fixing the number of directors also prevents management from changing the size of the board in order to maintain or enhance its control of the board. Proposals to increase or decrease the number of directors will be given careful consideration.

- [The fund] will vote against proposals to fix the range of the number of directors at fewer than 5 or more than 21.
- [The fund] will consider voting for proposals to fix the number of directors at fewer than five if the board does not have the usual full range of responsibilities of a public company board.
- [The fund] will vote against proposals to fix or set a range for the number of directors if less than two-thirds of the board's directors are independent.
- [The fund] will vote against proposals to fix or set a range for the number of directors if none of the directors are women and the company does not have an adequate diversity policy.

Director indemnification

Directors are indemnified when the company pays the expenses of directors who become involved in litigation as a result of their actions as directors.

- [The fund] will vote for proposals to indemnify directors if the indemnification is limited to actions undertaken honestly, in good faith, and with a well-founded belief that the actions were lawful.

Ratification of the acts of the board and/or auditors

Companies in some jurisdictions require shareholders' approval of the acts of their management and supervisory boards, and/or their auditors over the previous year. In most cases, this approval is symbolic, and it does not release the boards or auditors from liability.

Companies may also ask shareholders to release their boards and/or auditors from liability. The extent to which directors' and auditors' liability is limited by these votes varies with the jurisdiction. These votes require greater caution.

- [The fund] will vote for the ratification of the acts of boards unless it has reason for serious concern about the board's oversight of the company.
- [The fund] will vote against proposals to discharge auditors and/or directors from liability if the voting agent

or [the fund] has reasons to be concerned about the actions of either. Examples of such reasons are evidence of illegal acts or gross mismanagement, or of failure to provide shareholders with regular, audited financial statements.

Director compensation

Companies must compensate their directors adequately for the time and work required to fulfill their responsibilities. However, directors are in the awkward position of having to establish their own compensation. The potential conflicts that this presents can be alleviated to some extent by requiring all compensation packages for directors to be fully disclosed and explained in the annual proxy circular, and to be subject to shareholders' approval. This disclosure helps to protect the board's integrity, and models ethical behaviour for the rest of the company.

Directors should have compensation plans that are separate from executive compensation plans. Including directors in a management compensation plan can undermine the board's independence, because it tends to align directors' interests with the interests of the executives whose performance the board is supposed to oversee.

The same guidelines for the compensation of boards of directors can be applied to the compensation of supervisory boards, except for the requirement that directors own shares in the companies of the boards they sit on. Members of supervisory boards who are employee representatives are not shareholder representatives in the same way as directors are. Thus, they are not subject to the same requirements for share ownership as directors.

In all cases, director compensation must be structured in a way that will preserve the independence of the board and promote the long-term interests of all shareholders.

- [The fund] will support proposals to require directors' compensation packages to be subject to shareholder approval.
- [The fund] will vote against director compensation if the amounts or details of the compensation are not disclosed to shareholders before the meeting at which the vote takes place.
- [The fund] will vote against executive compensation arrangements that include directors and executives in the same plan.

Directors' share-based compensation

The board of directors represents the shareholders of a corporation; therefore directors should own shares of the corporation and hold them for the long term, ideally for the duration of their tenure on the board. However, requiring directors to own shares has some drawbacks. In particular, boards could lose the valuable experience and outlook of prospective directors who are not wealthy enough to make share purchases or to defer their fees in order to acquire shares. [The fund] supports requirements that directors own shares, but only if directors are not required to be shareowners before being nominated, and only if they are given a reasonable amount of time after being elected to acquire the shares. Share-based compensation for directors can support their ownership of shares, but it needs careful scrutiny to ensure that it truly aligns directors' interests with those of other shareholders and does not place undue pressure on directors to invest large amounts of money in the company.

Directors should not be granted stock options. Stock options only have value when the exercise price rises above the grant price, which tends to focus option holders' attention on short-term fluctuations in share price. Directors need to focus instead on the long-term interests of shareholders. Stock options also do not require directors to have capital at risk.

Plans to compensate directors with shares should be structured to encourage long-term holdings. These plans are subject to the same guidelines about expiry, dilution, and so forth as compensation plans for management.

- [The fund] will vote against stock option plans that are for or include non-management directors.
- [The fund] will vote against amendments to directors' share-based compensation plans that would allow those plans to be established, renewed, or changed without shareholder approval.
- [The fund] will vote case by case on proposals to require directors to own shares in the company, taking into consideration the terms of the requirement and how difficult the requirement will make it for nominees who are not wealthy to serve as directors.

Retirement benefits, severance pay, or incentive pay for directors and statutory auditors

[The fund] believes that retirement benefits are not appropriate for directors because they increase directors' financial reliance on the corporation, and this reliance may compromise director independence. Severance and incentive pay also undermine director independence for the same reasons.

If directors are also employed by the corporation, they may receive pensions for their employment but not for their service as directors.

This guideline also applies to statutory auditors.

- [The fund] will vote against proposals to provide retirement benefits, bonuses, or severance pay to directors and statutory auditors.

Disclosure of directors' compensation

Details of directors' compensation packages, including an estimate of the value of directors' share-based compensation and all other aspects of their compensation, should be disclosed to shareholders so that shareholders can cast informed votes on directors' compensation arrangements.

This includes disclosing the compensation paid to individual directors, members of supervisory and management boards, and statutory auditors.

- [The fund] will vote for proposals to disclose to shareholders all compensation paid to directors, including the value of share-based compensation.
- [The fund] will vote against directors' compensation if that compensation is not disclosed to shareholders in sufficient detail for shareholders to understand fully what the company is paying directors for their services.

AUDITORS AND FINANCIAL REPORTS

Auditor independence and the appointment of auditors

Auditor independence is vital to shareholders. A company's annual financial statement is usually the only independently verified information shareholders have about the company's performance and financial condition. Shareholders must be confident that they can rely on this information and that the auditors who reviewed the information have not been compromised.[12]

From time to time, companies hire their outside auditors to provide them with tax advice or other services. Some of these services are permitted under securities regulations. However, [the fund] believes that hiring the outside auditor to perform other work has the potential to compromise the independence of those auditors. [The fund] strongly prefers auditors that have not performed other services for a corporation and do not hold contracts to perform services other than the annual audit.

- [The fund] will vote for proposals to prevent the outside auditor from doing any work for the company other than work related to the annual audit, unless the company makes a compelling case that the number of accounting firms it can work with is too limited for this to be feasible.
- [The fund] will vote against auditors if more than one-third of the fees paid to the auditors in the previous year were for services other than the annual audit.

Disclosure of audit fees

At a minimum, companies should disclose all of their relationships with their auditors and all fees paid to their auditors. The fees for the audit and any non-audit services should be clearly identified. This disclosure is required for Canadian companies. [The fund] considers fees for tax services to be non-audit services.

- [The fund] will vote against auditors if the company does not disclose the fees it paid its auditor for the annual audit, audit-related services, and non-audit services in the previous year.
- [The fund] will vote for proposals to require companies to disclose the fees paid its auditor for the audit and for non-audit services.

Approval of auditors' fees

In some jurisdictions, companies must seek shareholders' approval to pay their external auditors. [The fund] will vote for these proposals unless it has concerns about the auditor's independence, as described in the section "Auditor Independence and the Appointment of Auditors," page 24.

- [The fund] will vote to approve payment of the auditor's fees unless there is a reason to question the auditor's independence.

Rotation of auditors

Companies that use the same accounting firm and audit partner to conduct their audits for long periods of time run the risk of developing a close relationship that can compromise the independence of their annual audit. In Canada, accounting firms are required to rotate their audit partners every seven years. In the United States, the Sarbanes-Oxley rules require firms to change their audit partner every five years. However, some jurisdictions do not require companies to change audit partners. At a minimum, companies should change their audit partner every seven years, regardless of whether or not they are required to do so by law.

- [The fund] will vote against the auditors if the company discloses how long its audit partner has held that position and the company has kept the same audit partner for more than seven years.
- [The fund] will vote for proposals that ask the company to change audit partners every seven years, unless local regulations require the audit partner to change more frequently. [The fund] will assess proposals for a greater or lesser period case by case.

Companies often do not disclose information about the tenure of their audit partner.

- [The fund] will vote for proposals that ask companies to disclose to shareholders how long their audit partner has served in that capacity.

[The fund] prefers that companies rotate their audit firms every six to ten years.

- [The fund] will vote for proposals that ask the company to change audit firms every six to ten years. [The fund] will assess proposals for a greater or lesser period on a case-by-case basis.

Certification of financial statements

Canadian and American securities regulations require the chief executive officer (CEO) and chief financial officer (CFO) of a company to certify the accuracy of the company's financial statements. Certifying that their financial statements are accurate makes CEOs and CFOs more accountable to shareholders. It also gives shareholders a greater level of confidence in the financial statements that they rely on to make investment decisions.

- [The fund] will vote for proposals that ask CEOs and CFOs to certify the accuracy of the company's financial statements where they are not required to do so by law.

Approval of financial reports

Proposals to approve the company's financial reports are routine matters at companies outside North America. However, some companies present the reports for which approval is sought only at the shareholders' meeting, rather than making the reports available to shareholders before the meeting. As a result, shareholders who are not present at the meeting do not see the report that the companies are asking them to approve. [The fund] finds this unacceptable.

Regardless of whether a vote of approval is required or not, all publicly traded companies should provide their shareholders with complete, audited financial reports at least annually, even if this is not required by law.

- [The fund] will vote for proposals to approve financial or directors' reports only if the reports are audited and available to all shareholders before the shareholders' meeting, and if [the fund] has no reason to be concerned about the quality of the reports or the independence of the auditor.
- If a company does not provide shareholders with complete, annual, audited financial reports, [the fund] will vote against proposals to ratify the acts of the board and/or the auditors.

Appointment of the auditor and financial restatements

A company's management is responsible for the accuracy of its financial statements and the quality of its internal financial controls. The external auditor issues its opinion of those statements and controls. However, the audit firm has some responsibility for detecting errors, fraud or illegal acts in the process of forming its opinion. If a company has had multiple financial restatements, or has engaged in financial misdeeds that the auditor did not report on, [the fund] may vote against the appointment of that audit firm. The decision to vote against an audit firm for this reason will be made case by case, depending on the severity of the company's error or illegal act and the likelihood that the audit firm would have detected it.

- If a company has a history of frequent financial restatements, or if it has engaged in financial misdeeds (such as back-dating stock options or misrepresenting its earnings) and the auditor has repeatedly missed this behaviour in its reports, [the fund] may vote against the audit firm.

EXECUTIVE COMPENSATION

Executive compensation is a controversial area of corporate governance. Compensation must be attractive enough to draw, motivate, and keep qualified executives. However, executive compensation is widely perceived to be excessive.

High levels of executive compensation have been found to correlate with financial misrepresentation. Several studies have shown that high levels of executive pay substantially increased the probability that a company would misreport its financial results.[13]

[The fund] does not intend to design executive compensation plans; this is the job of independent compensation committees. However, in cases where [the fund] believes that executive compensation has been consistently excessive, [the fund] may vote against the compensation committee or the entire board of directors. Furthermore, [the fund] intends to give executive compensation at all companies close scrutiny.

Compensation consultants

If compensation consultants are used in developing executive pay plans, they should be retained by the board's compensation committee, not by executives or candidates for executive positions. In order to avoid potential conflicts of interest, the consultant should not be engaged by the company for any other services. Some jurisdictions require

companies to disclose the fees paid to their compensation consultants. [The fund] supports proposals asking companies to disclose these fees.

- [The fund] will vote for executive compensation plans that it believes are fair, and will oppose those it believes are excessive. Compensation plans are fair if
  - they are linked to objective measures of the company's performance;
  - they are affordable given the company's overall financial position;
  - they provide an incentive for excellent performance over the long term and do not reward below-average performance; and
  - the total compensation for each executive is understandable and reasonable compared with pay levels for comparable positions in the industry and compared with all pay levels within the company.
- [The fund] will vote for proposals that ask companies to disclose the fees they pay their compensation consultants.

Executive compensation and performance

Recently, expert opinion has been divided on whether or not on performance-based pay is an effective way to motivate executives.[14] [The fund] is watching this debate with interest. Given the absence of a consensus on the effectiveness of performance-based compensation, [the fund] will maintain its support for performance-based pay for executives for the present. Should companies wish to eliminate their executives' performance-based incentive compensation, [the fund] will not oppose it if those companies provide well-reasoned, evidence-based explanations for why they have done so.

Otherwise, [the fund] expects that most of executives' compensation and all of their incentive compensation will be based on performance.

Shareholders' most frequent opportunities to vote on executives' performance-based pay are the advisory "say-on-pay" votes on compensation policies or reports, which are discussed in a later section. The guidelines for voting in this section apply to all forms of compensation that might be included in an incentive compensation package.

Goals and targets for executives' performance-based pay should be established at the beginning of the evaluation period and should not be lowered except in very unusual circumstances. If the board decides to lower goals or targets, it should provide shareholders with the reasons for that decision. Goals and targets that are based on the company's performance relative to the performance of other companies should list those companies and explain the basis on which they were selected for the comparison.

Performance goals must be within the control or influence of the employee being evaluated. This excludes goals such as increases in stock price, which are not necessarily within the control of an individual executive and may not reflect the performance of the company itself. Performance goals should also focus on the company's profitability in the long term. This includes qualitative goals that contribute to long-term value, such as customer satisfaction, product quality, or employee development.

Companies that use measures of financial performance on a per-share basis, such as earnings per share, can artificially improve their performance by repurchasing shares, and thus give executives unearned compensation. [The fund] opposes this practice.

One way to compare executives' compensation to a company's financial performance is to calculate how much of the company's income is being paid to its five highest-paid executives. This ratio, called the Cost of Management Ratio (COMR) is calculated by adding the total compensation of the five highest-paid executives and dividing the sum by either the company's net income after taxes or its earnings before interest, tax, debt and amortization. The result should be approximately 1%. Results that are substantially higher than this indicate that a company's executive pay is excessive relative to the company's financial performance.

- [The fund] will vote against executive compensation plans that do not include performance-based compensation, unless the company provides a well-reasoned explanation for not including performance-based pay in its executives' compensation.
- [The fund] will vote against incentive compensation that is not based on performance.
- [The fund] will vote against executive compensation plans that allow incentive compensation to be paid for below-average performance.
- [The fund] will vote against executive compensation that is excessive, given the company's performance.
- [The fund] will vote against compensation plans if the company uses per-share financial measures as significant performance criteria and the company has repurchased shares or asks for the authority to repurchase its shares.
- [The fund] will vote against compensation plans if share price is a significant measure of performance for determining the amount of compensation under the plan.

- [The fund] will vote against incentive compensation plans if the company does not disclose the performance criteria on which the compensation is based. It will also vote against plans when the company's disclosure about the performance criteria is so vague that shareholders cannot determine what measures of performance are being used to award performance-based pay.
- [The fund] will vote against incentive compensation if the company lowered any executive's performance goals or measures after they were originally established, unless the company provides good reasons for the adjustment.

Performance-based compensation and restated financial reports

From time to time, companies award performance-based pay to their executives based on financial results that later have to be restated. Most companies have "clawback" provisions that require executives to pay back part of their compensation to reflect the restated financial reports. Some jurisdictions require clawbacks by law. [The fund] supports this. Executives should not benefit from inaccurate accounting. Requiring repayment of bonuses based on inaccurate financial statements is a good incentive for management to be cautious about their financial reports.

- [The fund] will vote for proposals asking executives to pay back an appropriate portion of their compensation when that compensation is based on financial information that must later be restated, unless the restatement does not affect the criteria on which the compensation was based.

Executive compensation during layoffs

Increasing the pay of management while laying off employees contradicts the principle that compensation should be linked to performance. If the company's performance is so weak that employees must be laid off, then it does not warrant an increase in executive compensation or benefits.

- [The fund] will vote for proposals to require the company to halt any increase in executive compensation during layoffs, including freezing executives' salaries, restricting the exercise of share-based compensation, and cancelling bonuses.

Executive performance and corporate social responsibility

A company's performance cannot be measured entirely by annual financial statements. The value of a company includes such factors as the environmental sustainability of its practices, its employees' morale and safety, and the well-being of the communities in which it operates. These factors all contribute to a company's value in the long run. For this reason, [the fund] encourages directors to evaluate executives' contributions to the company's financial, environmental, and social performance.

Companies must be careful, in choosing measures of performance, not create perverse incentives that undermine the behaviour they wish to reward. For example, bonuses based on a decrease in a company's reported on-the-job injury rate can result in employees being discouraged from reporting workplace injuries, instead of resulting in fewer injuries and better safety on the job. Measures of executives' social and environmental performance should be well-considered and within the executives' control.

- [The fund] will vote for proposals to link executive compensation to well-considered, objective measures of performance on social and environmental issues, as well as to measures of financial performance.

See also "Corporate Social Responsibility," page 41.

Executive compensation and employee wages

The growing income disparity between the wealthiest segment of the population and the majority of working people has been receiving more attention. Over the past thirty years, income inequality has increased in all of the OECD countries.[15] This increase in the incomes of the highest-paid workers is reflected in the compensation of executives, who are often among the so-called 1%.

In 2013, the average compensation of the 100 highest-paid CEOs of Canadian companies was approximately 160 times the median income of all Canadian workers.[16] This disparity between the compensation of executives and workers can have a material effect on the value of a company by lowering employee morale and productivity, increasing employment costs, and lowering profitability. Conversely, companies with higher levels of employee satisfaction—which is influenced by fair compensation for their contributions to the company's success—tend to have higher earnings and stock returns in the long run.[17]

Disparities in compensation also have a detrimental effect on entire economies. As the middle class shrinks and the purchasing power of workers dwindles, companies may find that their customer base grows smaller as fewer people are able or willing to buy what companies sell. Large disparities in pay also correlate with asset bubbles and related crashes, and with widespread public distrust of business.[18]

Most shareholder proposals addressing this issue have asked companies to report on the difference in the compensation of their executive and non-executive employees, or to set a maximum range or ratio that they will allow between the

compensation of the two groups of employees. These are often called "vertical" pay comparisons.

Vertical pay comparisons are appealing, but they also pose some problems. For example, companies may exclude offshore employees from a ratio in order to remove either lowest range or highest range of compensation and make the company's compensation appear more equal than it really is. Or companies may choose to outsource more low-wage work in order to avoid including very low-wage workers in the ratio. If companies include vertical pay comparisons in their compensation disclosure, that disclosure should include how the comparison was calculated and which groups of employees were and were not included.

Although there is no single, optimal ratio of executives' pay to workers' pay, it is not in the best interests of any company for the gap between executive and employee compensation to be large enough to affect the company's long-term performance.

Companies listed on US stock exchanges will be required to disclose a comparison of the CEO's compensation to the median compensation of the company's other employees, beginning in 2017.[19]

- [The fund] will vote for proposals that ask companies to provide shareholders with a comparison of the compensation of their executive and non-executive employees, as described above, provided the reports can be produced without undue expense or revealing confidential information.
- [The fund] will vote on proposals to establish a specific ratio between executive compensation and workers' compensation case by case.

Approval of compensation committee report and/or compensation policies

(Also see "Disclosure of Executive Compensation," page 28.)

Companies that put their compensation reports or policies to a vote at the annual shareholders' meeting give shareholders a say on the form and amounts of the compensation given to executives. These votes are often referred to as "say on pay."

- [The fund] will vote for proposals that ask companies to submit their compensation policies or compensation committee reports to an advisory vote of shareholders.

[The fund] will use its vote on these proposals to express its disapproval of executive compensation plans that are not in the interests of shareholders and other stakeholders, as defined by the guidelines in this section and other relevant guidelines. [The fund] will also vote against executive pay plans that include directors and executives in the same plan.

- [The fund] will vote against compensation policies or compensation committee reports if it believes executive compensation is excessive, or if it has concerns about any aspect of the company's compensation plan.
- [The fund] will vote against compensation policies or compensation committee reports if the company fails to provide an adequate explanation of how and why the compensation committee decided to structure the company's executive compensation as it did.
- [The fund] will vote against the approval of executive pay plans if they include directors and executives in the same plan.

Annual approval of compensation reports or plans

Some companies propose that shareholders be allowed to vote on their compensation policies or reports every two or three years, instead of annually. While this is an improvement over no shareholder say-on-pay vote at all, an annual vote is preferable. Shareholders' votes on executive pay plans are a form of communication; the vote lets shareholders tell the board whether or not they approve of the company's compensation practices. But that communication becomes harder to interpret as the time between votes becomes longer. If a vote is held every three years, the board does not know whether shareholders are objecting to something in executive compensation from this year, or from three years ago. An annual shareholder vote on executive compensation is easier for boards to understand and respond to.

- [The fund] will vote for proposals to adopt an annual shareholders' vote on executive compensation.
- [The fund] will vote for proposals to adopt biannual or triennial shareholder votes on executive compensation only if the company currently has no shareholder votes on executive compensation and there is no option for an annual vote.

Disclosure of executive compensation

In order to vote wisely on compensation issues, sharehold-ers must understand the company's executive compensa-tion plan and philosophy. The company should describe its entire executive compensation plan clearly in its proxy circular, including incentive pay, share-based compensation, severance arrangements, retirement benefits, perquisites, and any other contractual obligations of the company to named executives. The company should disclose the basis

on which awards are made for each plan, such as the specific performance criteria. It should list the companies it uses as a comparison group, and it should explain the choice of those companies. It should also disclose the full value of all compensation. Where the value of a benefit must be estimated (such as with retirement benefits), companies should disclose the basis on which the estimate was made. The value of executives' share-based compensation should be included in the proxy materials, and not just in the financial statements. This disclosure may go beyond what the company is legally required to disclose about its executive compensation.

Canadian companies are required to disclose their executives' compensation according to the revised regulations of the Canadian Securities Administrators (Form 51-102F6). Other jurisdictions also have regulations that require companies to disclose certain information about their executive pay practices.

The company should name any compensation consultants who have advised it and describe the consultants' mandate. The company should also disclose information about any potential conflicts of interest the consultants may have, such as contracts with senior managers.

- [The fund] will vote for proposals to require companies to disclose and fully explain their executive compensation plans to shareholders.
- [The fund] will vote against compensation plans if disclosure of the plans does not comply with applicable regulations. For Canadian companies, these are the requirements in CSA Form 51-102F6.
- [The fund] will vote for proposals that ask companies to disclose the names of their compensation consultants, the consultants' mandates, fees, and information about any potential conflicts of interest.
- [The fund] will vote against compensation plans if the information described in this section is not disclosed for the plan, or if the disclosure is otherwise found to be inadequate.

Share-based compensation

In principle, the inclusion of share-based compensation in executive compensation plans benefits a company's shareholders. Share-based compensation encourages executives to own shares in the company, thereby aligning their interests with those of shareholders.

However, share-based compensation can also give executives an incentive to focus on their company's share price instead of its "real" performance - that is, improving its productivity, profits, customer satisfaction, and doing a better job of whatever the company does. Share-based compensation has also been a common source of excessive executive compensation. For these reasons, share-based compensation requires careful scrutiny from shareholders.

All share-based compensation plans should be subject to regular re-approval by shareholders even if applicable regulations do not require it.

Expiry

All forms of share-based compensation should expire within five years of the date they are awarded unless applicable laws require that the expiry date be further in the future.

- [The fund] will vote against share-based compensation that has no expiry date or an expiry date further than five years in the future.
- [The fund] will vote against any proposal that would allow the board to extend the expiry date of share-based compensation without shareholder approval, unless the expiry date falls within a trading-blackout period.

Dilution

[The fund] defines dilution as the number of shares available for share-based compensation plus all of the share-based compensation that has been awarded but not yet exercised, divided by the total number of shares outstanding. This is sometimes called the overhang.

Share-based compensation plans dilute the earnings and voting strength of the company's shares. The level of acceptable dilution is relative to the size of the firm. Small companies may have a dilution rate of as much as 10%, but larger companies should have less dilution.

In rare instances a dilution rate slightly higher than 10% may be acceptable; these instances will be determined case by case.

- [The fund] will vote against share-based compensation plans if the company's total dilution is more than 10%.
- If a company's overall dilution is more than 5%, [the fund] will vote for share-based compensation plans if the plans meet at least one of the following criteria:
- the plan is open to all employees, or a large proportion of them;
- the company is a growth company;
- the company is in a difficult financial situation;
- the company has set its grant rate at a maximum of 1%;

- the company was recently created by a merger, and two or more compensation programs are being combined, requiring a period of adjustment; or
- the company's compensation is below competitive levels for its industry.

Grant rate

The grant rate or burn rate of a plan is the percentage of outstanding shares granted as compensation in a year. High grant rates are dilutive. Grant rates should be no more than 2% of the company's outstanding shares. A grant rate above 1% warrants particular scrutiny of the plan's dilution.

- [The fund] will vote against share-based compensation if the average grant rate for the past three years is 2% or more. [The fund] may also vote against plans that grant stock options with grant rates above 1%, especially if their dilution is also above 5%.

Reload grants

A reload grant automatically gives the recipient additional units of share-based pay (such as stock options or restricted shares) when the original options are exercised. Reloading share-based pay is dilutive. Reloading options also make it possible for the recipient to lock in increases in share price with no attendant risk, a benefit not available to other shareholders.

- [The fund] will vote against share-based compensation plans with reload provisions.

Automatic replenishment features

Share-based compensation is granted from a pool of shares set aside for that purpose. Traditionally, the number of shares in the pool is subject to shareholder approval. Normally, when that pool of shares is becoming depleted, the company must seek shareholder approval to set aside additional shares for compensation. However, share-based compensation plans with automatic replenishment features automatically replace the shares available to be granted as compensation, without prior shareholder approval. [The fund] does not approve of plans with automatic replenishment features because they tend to be highly dilutive.

There may be cases in which the grant rate of a company's compensation plans is so low that, even with the automatic replenishment feature, the company's overall dilution is still well below 10%. For example, many Japanese companies that have stock option plans have very low grant rates and overall dilution rates of only 1% or 2%. In these cases, an automatic replenishment feature may be acceptable provided the company's overall cumulative dilution will not exceed 10% over the duration of the plan.

The Toronto Stock Exchange allows companies to include automatic replenishment features in their compensation plans provided they seek re-approval from shareholders every three years and cap the plans' dilution at no more than 10%. However, this has made 10% the standard level of dilution rather than the maximum. [The fund] does not believe that automatic replenishment features are in the best interests of companies or their shareholders.

- [The fund] will vote against compensation plans that include an automatic replenishment feature. An exception to this guideline may be made if the company's cumulative overall rate of dilution is so low that it is unlikely to exceed 10% for the duration of the plan.

Evergreen awards

Evergreen awards are given to recipients automatically at certain intervals. The awards are usually for a fixed percentage of the company's outstanding shares. Evergreen awards are not common. [The fund] is opposed to them because they are dilutive, they are not based on performance, and because they are made automatically they may be awarded without review by board's compensation committee.

- [The fund] will vote against evergreen compensation, and compensation plans that include an evergreen component.

Vesting

Long-term share-based compensation should have a minimum holding or vesting period before it can be exercised. Share-based compensation is not an effective tool for encouraging executives to manage for the long term if the awards can be exercised as soon as they are granted. (See also "Change-in-Control Provisions," page 32, regarding accelerated vesting contingent on changes in control of the company.) Share-based compensation in long-term plans should be held for at least three years to promote long-term stock holdings. Some jurisdictions have established minimum vesting periods by law or regulation.

This may not apply to share-based compensation that vests according to performance criteria. In some situations, a board should be able to extend or waive vesting periods, but these should be exceptional cases.

- [The fund] will vote against long-term share-based compensation plans that have a vesting period of less than three years, unless the awards vest based on reasonable performance goals.

Stock options

Stock options are used less in executive compensation packages than they once were but they remain a focus of

concern. Stock options have value only when the company's share price rises above the price of the shares when the options were granted. As a result, stock options give executives an incentive to focus on the share price rather than on the company's performance and best interests in the long term. At their worst, stock options can encourage executives to take risks that increase the share price but are not in the best interests of the company in the long term.

As we noted earlier, share price is not a good measure of performance, since prices can rise or fall for reasons that are unrelated to the performance of the company or any executive. As a result, stock options by themselves are not an effective way to link pay to performance.

- [The fund] will vote for proposals to eliminate stock options as a form of executive compensation, unless the options have performance requirements or there is a compelling reason not to eliminate them.

Price

Stock options should be issued at or above the market price of the company's shares at the time of issuance.

In theory, stock options give executives an incentive to manage the company in a way that makes the share price rise. But if the options are issued at less than the market price of the shares, they lose their value as an incentive for executives to work to increase the share's price.

- [The fund] will vote against executive compensation plans that offer options at a price below the shares' market price.

Repricing

When the market price of a company's shares is lower than the exercise price of the stock option, the options have no monetary value. These are called underwater options. Companies with underwater options may seek to change the options' exercise price to match the lower market price, withdraw the options and reissue them at the lower price, or exchange the options for another form of compensation. Any of these practices undermines the purpose of awarding share-based compensation by eliminating for executives the risk that other shareholders must accept in order to invest in the company. Some jurisdictions require companies to seek shareholder approval for repricing, but others do not.

- [The fund] will vote against repricing stock options or reissuing underwater options.
- [The fund] will vote against stock option plans that do not explicitly prohibit repricing, reissuing or exchanging underwater options.
- In general, [the fund] will vote against stock option plans if, in the past three years, the company has repriced or replaced stock options without shareholder approval. [The fund] will make exceptions if the plan and the directors responsible for the repricing have been replaced.

Timing

The value of stock options can be manipulated by timing the awards to maximize the difference between the share price when the options are awarded and when they are exercised. For example, stock option awards have been "back-dated" to a date when the share price was particularly low. These practices should be prohibited in compensation plans.

Stock options should be awarded at pre-determined intervals or dates, in order to prevent the manipulation of the options' value.

- [The fund] will vote against compensation plans if they do not have fixed dates or intervals for awards or if they do not prohibit timing awards of stock options in ways that artificially increase the value of the award.

Restricted shares

Restricted share plans award shares to recipients or allow the recipients to purchase shares with some restrictions or vesting requirements. In most cases the shares do not vest for a specified period of time, and/or until certain performance criteria are met. Restricted shares that vest when performance criteria are met are sometimes called "performance shares" or "performance rights."

Vesting periods for restricted shares should be at least three years. If restricted shares are being used as a form of incentive pay they must include performance criteria. Restricted shares that have no performance criteria, either for the initial award or for vesting, are effectively rewards for tenure instead of rewards for good performance. When performance-vesting restricted share plans are established, the company should disclose what the performance criteria are.

- [The fund] will vote against restricted share awards that do not have a vesting period or that vest in less than three years.
- [The fund] will vote against incentive compensation plans if the plan includes restricted shares that have no performance conditions.
- [The fund] will vote against performance-vesting restricted stock awards if the performance criteria for vesting are not disclosed or are too vague for shareholders to determine what recipients are being rewarded for.

Share subscription rights (Japan)

Under Japanese law, boards can issue options to purchase shares, called share subscription rights, without specifying the purpose of the options, who the recipients of the options will be, or what the strike price of the options will be. [The fund] is opposed to this practice because the options can be discounted or priced at a premium at the board's discretion, and because unspecified share issuances have the potential to dilute the value of existing shareholdings.

- [The fund] will vote against the issuance of share subscription rights unless:
- the price of the shares is specified and is comparable to the market price of the company's shares;
- the number of shares to be issued is specified;
- a specific purpose is given for the shares to be issued; and
- the recipients of the rights are identified.

Share subscription rights can also be used as a takeover defence. See "Poison Pill Takeover Defences," page 34.

Other kinds of share-based compensation

Other forms of share-based compensation include stock appreciation rights and phantom stock. Stock appreciation rights pay cash to recipients based on the amount the company's share price rises over a set period of time. Phantom stock is similar in that it pays recipients for increases in the value of a fixed number of shares.

Both kinds of awards do not cause any dilution and may discourage insider trading, but they do not encourage recipients to own shares in the company. They also reward executives for increases in the price of the company's shares that may be unrelated to the performance of the executives or the company.

- [The fund] will vote for alternative share-based compensation only if the awards are based on the executive's performance and if the compensation plan effectively aligns executives' interests with those of shareholders.

Omnibus share-based compensation plans

Omnibus share-based compensation plans, which bundle more than three kinds of share-based compensation into one plan, do not allow shareholders to vote on each component of the plan separately.

[The fund] will review each part of an omnibus share-based compensation plan for its dilution, vesting schedule, performance criteria, etc. As with other omnibus proposals, if any aspect of the plan does not conform to our guidelines, [the fund] will vote against the entire plan.

- [The fund] will vote against omnibus share-based compensation plans if any aspect of the plan does not conform to these guidelines.

Concentration of share-based compensation

- [The fund] will vote against plans that allocate 20% or more of the shares available for compensation in a given year to a single individual. Exceptions to this may be made for small companies that have few employees with share-based compensation or for companies that do not use much share-based compensation.

Awards for consultants and contractors

Companies sometimes extend their executive share-based compensation plans to their consultants or contractors. [The fund] is opposed to this practice. Share-based compensation is intended to motivate employees to improve the company's performance over the long term. However, people who are not employees and whose work for the company is short term have no reason to be motivated to improve the company's value in the long term.

- [The fund] will vote against share-based compensation plans that include consultants, contractors or other temporary employees.

Company loans for stock purchases

[The fund] opposes the practice of making loans to employees to allow them to purchase shares, even if the loans are made at market rates. This practice may leave the company with uncollectible debt and inhibit the termination of employees who have outstanding loans with the company. These loans are illegal in some jurisdictions.

- [The fund] will vote against compensation plans that provide for loans to employees to make share purchases.

Change-in-control provisions

(See also "Vesting," page 30, and "Severance Benefits," page 33).

Changes in control of a company have a significant effect on share-based compensation. The company's shares may be cancelled or replaced by the shares of the new or acquiring company. Share-based executive compensation plans should not allow executives to receive more for their shares than other shareholders receive from a change in control. Change-in-control provisions should require control of at least 50% of the company's shares to change. Some executive compensation plans define changes of control as less than 50% of the shares.

- [The fund] will vote against share-based compensation plans with change-in-control provisions if they allow holders of share-based compensation to receive more for their shares than other shareholders receive for their shares.
- [The fund] will vote against change-in-control provisions that are developed in the midst of a takeover fight.
- [The fund] will vote against change-in-control provisions that are triggered by changes in control of less than 50% of the company's shares, or by an event that does not involve changes in share ownership, such as changes in the board of directors.

Share-based compensation plans often include provisions that allow share-based grants to vest immediately if ownership or control of the company changes. These provisions can create an incentive for executives and directors to pursue changes in control that benefit them but not other shareholders. Change-in-control provisions also have been used to pay executives and directors substantial amounts for changes in control of the company that were initiated but never completed. These problems can be addressed by allowing an executive's share-based compensation to vest only if a change of control is completed and the executive also loses his or her job with the company as a result. These are called "double-trigger plans," as opposed to "single-trigger plans," which require only a change of control for share-based awards to vest.

- [The fund] will vote for proposals to require change-in-control transactions to be complete before any change-in-control provisions of compensation plans come into effect.
- [The fund] will vote against compensation plans that allow an executive's share-based compensation to vest if a change in control takes place, unless the executive's employment with the company is terminated as a result of the change in control.

Severance benefits

(See also "Change-in-Control provisions," page 32)

Executive severance benefits are controversial, especially when they result in large payments to executives who have performed poorly. Severance benefits should not be paid to executives who are fired or who resign in lieu of being fired for poor performance.

The amounts of compensation in executives' severance arrangements can be excessive, especially in light of the amounts of other compensation that executives typically receive. In general, [the fund] believes severance packages are excessive if they provide benefits worth more than two times an executive's base salary plus annual bonus.

Executives often receive special severance benefit packages, called "golden parachutes" if they lose their jobs as the result of a change in control. The purpose of golden parachutes is to ease managers' concerns about losing their jobs in the event of a successful takeover, and thus help them to make decisions that are in the best interests of the company and its stakeholders. However, the amounts of change-in-control severance benefits are often very large, which can give executives an incentive to pursue changes in control of the company regardless of the effect on shareholders, employees and other stakeholders. [The fund] will decide how to vote on each case individually, but we do not look favourably on golden parachutes for all of the reasons above. Executives should not be unduly penalized by changes in control of a company, but they also should not benefit at the expense of other stakeholders.

- [The fund] will vote case by case on executive severance benefits. However, we will only vote for them if the company can demonstrate that the arrangements are in the long-term interests of its stakeholders, that they do not create a conflict of interest for the recipients, and that the amounts involved are reasonable.
- [The fund] will vote against any severance arrangements that allow executives to receive severance pay if their performance or the performance of the company has been unsatisfactory.
- [The fund] will vote against any severance plan triggered by a change in control that is not contingent on the completion of the change of control of the company, that is, a completed change in the ownership of more than 50% of the company's shares or voting rights.

Severance benefits for directors are inappropriate because they may create potential conflicts of interest and compromise director independence. If the benefits are large, they may also give directors an incentive to pursue a change in control of the company that is not in the best interests of other stakeholders.

- [The fund] will vote against change-in-control or severance benefits for directors.

Exceeding regulatory limits on severance

Some jurisdictions have regulations that set an upper limit on the amount of severance pay that a company may award its executives, unless shareholders approve a larger amount. [The fund] opposes paying executives larger severance packages than are permitted under applicable regulations.

- [The fund] will vote against proposals to award executives larger severance payments than would be allowed under applicable regulations.
- Shareholder approval for executive severance compensation
- [The fund] will vote for proposals to require all severance packages for executives to be approved by shareholders.

Tax "gross-ups"

Companies sometimes pay executives additional amounts to cover the taxes on parts of their compensation. [The fund] is opposed to this practice. We believe that executives' compensation is, in the main, already quite generous and that executives can reasonably be expected to pay their own taxes.

- [The fund] will vote against executive pay plans that include tax "gross-ups" or additional amounts to cover the cost of taxes on any part of the compensation.

Compensation caps

Compensation caps are a somewhat arbitrary way to control excessive executive compensation. In general, they violate the principle that employees should be rewarded for their performance, and they have the potential to make a company's compensation plan uncompetitive. However, there are instances in which they may be the best means available to rein in runaway executive compensation.

- [The fund] will assess proposals for compensation caps on a case-by-case basis. In general, it will vote against them, unless executive compensation is excessive given the company's performance and there is no other effective way to limit that compensation.

TAKEOVER PROTECTION

Mergers, acquisitions and takeovers are common. Shareholders must be vigilant about protecting their interests in these transactions. These transactions may pay a premium to shareholders and improve a company's performance, but they can also injure the company's long-term profitability and have adverse effects on its stakeholders. Decisions about whether or not to accept a merger or acquisition must be based on what will best serve the company and [the fund's] beneficiaries in the long term.

Measures designed to protect companies from takeovers must also be evaluated carefully. Takeover defences often depress the price of a company's shares, and may protect the interests of directors and executives more than they protect the company or its other stakeholders. When presented with a takeover defence shareholders should ask, who will benefit from this defence in the long term? Will the defence protect the company from acquirers who are not concerned with the company's long-term growth and profitability? Or will the defence entrench management at the expense of the company's other stakeholders? Takeover defences require special scrutiny to ensure that the company's long-term interests are protected.

Shareholders' approval of takeover defences, mergers, and acquisitions

Any action that alters the relationship between shareholders and the board, or that results in major changes in the structure or control of the corporation should be submitted to the shareholders for a vote. Shareholders should be given adequate information and enough time to make informed, well-considered decisions about these issues.

Any takeover defence may protect the interests of management and/or the board, regardless of whether or not a potential takeover would benefit the company. For these reasons, no company should adopt a takeover defence without approval from its shareholders, even if it is legally permitted to do so.

- [The fund] will withhold votes for or vote against all of the directors of a board that adopts a takeover defence without shareholders' approval.
- [The fund] will vote for proposals to require shareholders' approval before the company adopts a takeover defence.

Poison pill takeover defences

Poison pill takeover defences allow a company take some action that makes it very expensive for an unwanted acquirer to buy enough shares to gain control of the company. This takeover defence can take many forms. A few of the most common are described here.

Poison pill takeover defences can serve a legitimate purpose and benefit shareholders. However, they are also easy to abuse. Adoption of a poison pill often depresses a company's share price.

Shareholder rights plans

At the time these guidelines were being revised, the Canadian Securities Administrators had announced that they were developing new rules for shareholder rights plans, but those rules had not yet been made public. [The fund's] guideline is based on the most recent information available at the time, but they may not reflect the new rules once they are published.

Shareholder rights plans are a form of poison pill takeover defence commonly used in Canada. A company with a shareholder rights plan will issue stock-purchase rights to its shareholders. These rights cannot be exercised unless a takeover offer is tendered or a potential acquirer of the company purchases a specified percentage of the shares. If the company cannot negotiate a takeover arrangement with a prospective acquirer, the rights allow shareholders other than the acquirer to buy additional shares at very favourable prices. This makes the takeover much more expensive for the acquirer.

Shareholder rights plans are intended to push potential buyers of the company to negotiate with a company's board of directors, since buyers can avoid triggering the plan by doing so.

Shareholder rights plans have two legitimate purposes: they can ensure that all shareholders are treated equally in a takeover, and they can give the board time to negotiate a better deal with the acquirer or to solicit competing bids that would maximize the value of the company's shares.

However, shareholder rights plans also have drawbacks for shareholders. They can thwart takeover attempts that would benefit shareholders. They often cause the price of the company's stock to drop. And, like other takeover defences, shareholder rights plans can protect the directors and management rather than promoting the best interests of shareholders. Plans must be designed to protect the company from detrimental takeovers, rather than protecting the interests of the board and management.

Canadian companies must submit shareholder rights plans to a vote by shareholders when the plans are adopted, and they must seek shareholders' re-approval every three years.

- When shareholder rights plans are submitted for shareholder approval, [the fund] will assess the plans case by case. It will vote for them only when the plan ensures that shareholders will receive a fair price for their shares in a takeover and the plan will not protect management or the board at the expense of the shareholders' interests. [The fund] will vote for a plan only if
- the threshold for triggering the poison pill is at least 20% of the company's shares;
- the plan's definition of "acquiring person" excludes anyone who strays across this threshold without intending to take over the company, such as passive institutional investors;
- the plan's definition of beneficial ownership does not include references to voting agreements or dispositive power;
- the plan allows a bid to acquire the company that does not trigger the shareholder rights plan to go directly to the shareholders;
- partial bids are permitted with a minimum deposit requirement or with a minimum bid that conforms to the rules of the Canadian Securities Administrators;
- the bid stands for a maximum of 60 days, or 120 days if the rules of the Canadian Securities Administrators require it. At that time the board must either announce an alternative bid or allow the original bid to go to the shareholders;
- potential acquirers can continue purchasing the stock in accordance with applicable regulations during the period in which the permitted bid stands;
- if the board wants to waive or redeem the plan in order to allow the company to be acquired by means other than a takeover bid, the shareholders' prior approval is required;
- the board can waive the plan, allowing a takeover bid to be made by sending a takeover bid circular to all shareholders, as long as this waiver is extended to any other contemporaneous bids. In this case, all takeover bids must be made by sending a takeover bid circular to all shareholders before the expiry of the initial bid;
- the plan does not include "flip-over" provisions that allow shareholders to purchase discounted shares of an acquiring company after the takeover;
- rights can be redeemed only with shareholders' ratification;
- private placements are not exempted from the plan;
- soft lock-up agreements, in which shareholders can break the agreement to sell their shares to a competing offer, are exempted from the plan;
- the plan does not contain provisions that exempt insiders from the plan or parts of the plan;
- potential acquirers are not required to provide evidence of financing;
- the terms "beneficial ownership" and "acting jointly or in concert" are based on ownership of shares at law or in equity, not voting rights or agreements;
- the offer will be considered approved if a majority of the votes cast by independent shareholders are in favour or if a majority of shareholders tender their shares in response to the offer;
- the potential acquirer has the right to amend the offer before the shareholders' meeting;

- the plan will be resubmitted to shareholders for approval at least every three years; and
- any amendments to the plan will be submitted to shareholders for approval.

These guidelines also apply to poison pill takeover defences that are adopted to protect the tax treatment of net operating losses.

New share subscription rights and stock warrants as poison pill takeover defences

New share subscription rights are most commonly issued at Japanese companies. The rights are issued without a specified price and can be priced at a premium in the event of an attempted takeover. They function in much the same way as a poison pill takeover defence, by making a takeover of the company very expensive. Companies strengthen the defence by issuing the shares to a friendly third party or to employees, to make it more difficult for the acquiring party to purchase the company's shares.

The use of stock warrants as a poison pill takeover defence is more common at European companies than elsewhere. The warrants are issued to all shareholders except the would-be acquirer of the company. The exercise price of a stock warrant is usually higher than the current value of the shares, making it more expensive for a would-be acquirer to purchase the company's shares.

Some jurisdictions require companies to submit the use of warrants as a takeover defence for shareholder approval. As stated earlier, if a company adopts any version of a poison pill without shareholder approval, [the fund] will vote against the entire board at the next opportunity.

- [The fund] will vote against the issuance of new share subscription rights or stock warrants when they could or will be used as takeover defences.

Other variations on poison pill takeover defences

Other forms of poison pill takeover defences exist. All are designed to make it expensive for a prospective acquirer to buy the company without negotiating with the board of directors. Poison pill takeover defences are acceptable if they are designed to allow the board to negotiate the best possible deal for the company. However, the plans require careful scrutiny in order to be sure they benefit the company's stakeholders and not just management or the directors. These takeover defences must be evaluated individually. As with all other takeover defences, they should not be adopted without shareholder approval.

- [The fund] will vote on other poison pill takeover defences case by case. It will vote against plans that
  - allow the board to reject, without shareholder input, offers to acquire the company that do not trigger the plan;
  - are likely to discourage takeovers that could benefit the company; or
  - do not require the board to give equal treatment to all offers that comply with the rules of the plan.

Crown jewel defence

In a crown jewel defence against a takeover, the target company sells its most valuable assets to a friendly third party to make the company less attractive as a takeover target. In Canada, crown jewel defences usually require the approval of shareholders. Shareholders can also seek the fair value of their shares from the potential acquirer if the majority of the target company's assets are included or if the takeover would change the essential nature of the company's business. This occurrence is known as the appraisal remedy.

Crown jewel transactions are often made on very short notice, giving shareholders little time to consider how the transaction will affect the value of their shares or control of the company.

- [The fund] will vote against crown jewel transactions unless the company demonstrates that the shareholders' interests will be protected.

Private and targeted share placements

A company's management or directors may protect themselves from a takeover by placing a large block of shares in a safe place, such as their employee stock option plan or with a sympathetic individual shareholder, so that those shares cannot be purchased. Private and targeted share placements do not benefit shareholders if they result in dilution or if a takeover would be in the best interests of the company.

- [The fund] will decide how to vote on private and targeted share placements case by case.
- [The fund] will vote for proposals to require companies to seek shareholder approval before making any targeted or private share placements that involve more than 5% of the existing shares.

Opting out of takeover laws (United States)

In the United States, some states have laws that protect corporations from hostile takeovers. These laws often include provisions that allow corporations to opt out of their protections. In general, takeover-protection laws prohibit prospective buyers from making well-financed bids for a company, thus providing a benefit to shareholders. Takeover-protection laws may also limit directors' fiduciary obligations to shareholders.

- [The fund] will vote for proposals to opt out of takeover-protection laws.

Reincorporation

(See also "Reincorporation in Off-Shore Tax Havens," page x.)

Companies may reincorporate in a different jurisdiction for sound business reasons, but also as a takeover defence or as a way to limit the directors' liability. [The fund] will assess votes on reincorporation case by case.

- [The fund] will vote for reincorporation proposals when management can demonstrate that there are sound financial or business reasons for the move.
- [The fund] will vote against reincorporation if it is being used as a takeover defence, to limit director liability, or if shareholders' rights would be diminished as a result. [The fund] will also vote against reincorporation to a jurisdiction with weaker corporate governance requirements.

Greenmail

A company pays greenmail when it buys shares held by a would-be acquirer at a price above the market price, usually in exchange for the would-be acquirer's agreement to end a takeover attempt.

Provincial securities laws do not permit greenmail payments in Canada. However, they do occur in some jurisdictions. Greenmail is unfair to the shareholders, who do not get the preferred price for their stock. It also decreases the value of the company's stock, which further hurts shareholders. In addition, greenmail denies shareholders the opportunity to decide whether or not the prospective takeover is in their best interests.

- [The fund] will vote for anti-greenmail proposals.
- If shareholders have the opportunity to vote on a greenmail payment, [the fund] will vote against it.
- If greenmail is paid and no vote is offered on the greenmail payment, [the fund] will withhold votes from the directors who approved it. (See "Voting for Directors," page 14.)

Fair-price proposals

Fair-price proposals require a bidder for a corporation's shares to pay the same price for all of the company's shares purchased. The fair price is usually defined as the highest price paid by the bidder for any shares acquired before the start of the tender offer. These proposals ensure that all shareholders are treated equally in a takeover. They defend against two-tiered offers in which a higher price is paid in the initial offer (often to make a takeover bid attractive to shareholders) but a lower price is offered for the remaining shares. Two-tiered offers are effectively prohibited in Canada but are allowed in other jurisdictions.

- [The fund] will vote for fair price proposals.

Miscellaneous takeover defences

When a company proposes or invokes other takeover defences not listed here, those defences should be evaluated case by case to determine what the overall, long-term benefits of the proposal are.

- [The fund] will assess votes on other takeover defences individually, based on how they will affect the company and its stakeholders in the long term.

Considering the effects of takeovers and mergers

As noted at the beginning of this section, takeovers are common but they do not always benefit the company or most of its stakeholders. Therefore, shareholders must consider whether or not proposed mergers and acquisitions are in their best interests in the long term and be prepared to vote against transactions that are not.

Some investors have proposed requiring directors to consider the effects of mergers or acquisitions on employees, suppliers, the surrounding communities, and other stakeholders. [The fund] believes that these proposals can enhance the long-term value of a company. An evaluation of the broader effects of mergers and acquisitions may reveal hidden costs, such as reduced productivity due to job losses or responsibility for environmental damage.

- [The fund] will vote for proposals that ask directors to consider the effects of mergers, takeovers, or acquisitions on employees, suppliers, the surrounding communities and other stakeholders.
- [The fund] will vote on proposed acquisitions and mergers case by case, taking into consideration the long-term consequences of the proposed transactions for shareholders, employees, suppliers, local communities, and other stakeholders.

PROTECTION OF SHAREHOLDERS RIGHTS AND INTERESTS

Exclusive forum proposals

Some companies ask their shareholders to approve amendments to their articles or bylaws that limit the jurisdictions where shareholders can file lawsuits against the company. These are called exclusive forum proposals. In most cases,

these bylaw amendments state that cases against the company can only be brought in courts in the state of Delaware, or only in the Delaware Court of Chancery.

[The fund] opposes bylaw provisions that restrict where shareholders can sue a company. We recognize that limiting shareholders' lawsuits to a particular forum has financial benefits for the company. However, it is not clear that these restrictions are enforceable. Furthermore, exclusive forum provisions are an unacceptable limit on shareholders' rights. They deprive investors of the right to choose the court in which to sue a company. The provisions are also too broad, because they include all lawsuits by investors without demonstrating a need for such a restriction.

- [The fund] will vote against proposals to limit the jurisdictions where shareholders can file suit against the company.
- [The fund] will vote for proposals to remove exclusive forum provisions from a company's bylaws or articles.

Supermajority vote requirements

Supermajority requirements require the vote of more than a simple majority to approve a decision or transaction. [The fund] generally opposes supermajority requirements because they are often used to prevent beneficial changes to a company or to secure managers' control of the corporation.

- [The fund] will vote against supermajority requirements and for proposals to eliminate them, unless there is a compelling reason not to do so.

Omnibus or linked proposals

Omnibus proposals combine two or more issues into a single proposal, which is presented to shareholders for a yes-or-no vote. Examples are combining a group of bylaw changes into one proposal, or combining several types of stock-based compensation for executives into a single proposal that shareholders can only vote for or against.

The US Securities and Exchange Commission will not permit proposals to be combined into an omnibus proposal if shareholders could reasonably be expected to vote against management's recommendations on any of the proposals if they were separate. However, the SEC allows exceptions for amendments to share-based incentive compensation plans, bylaw or charter amendments, or "inextricably intertwined" proposals.

[The fund] objects to omnibus proposals because they lump together issues that shareholders should be permitted to vote on separately. Omnibus proposals may also combine an issue shareholders are likely to support with one they are unlikely to support, in order to get approval for proposals that shareholders would not otherwise approve.

- [The fund] will vote against omnibus proposals, if it is opposed to any of the issues in the proposal, unless the overall effect of the proposal would benefit the company and its stakeholders in the long term.
- [The fund] will vote for proposals to prohibit the use of omnibus or linked proposals.

Confidential voting

Proxy voting typically is not done by secret ballot. This allows management to contact dissenting voters and urge them to change their votes. [The fund] believes that the proxy voting process should be confidential, impartial, and free from coercion. It supports proposals to institute confidential voting.

- [The fund] will vote for proposals to adopt confidential proxy voting.

Related-party transactions

Companies in some markets ask their shareholders to approve related-party transactions, in which the company engages in business transactions with a company or organization that has ties to its directors or executives. These transactions create potential opportunities for self-interested deals and conflicts of interest, which can compromise the board's independence or the perceived integrity of the company. In most cases, the products and services obtained through these transactions can be obtained from other sources that do not pose a risk to the board's independence or the company's reputation. Related-party transactions will only be approved if the company's access to suppliers or service providers is limited, if the company fully discloses the potential conflicts of interest, and if it has a procedure in place to protect itself from those potential conflicts.

- [The fund] will vote case by case on proposals to approve related-party transactions with companies or organizations that have ties to the directors or executives, using the criteria given above.

Quorum requirements for shareholders' meetings

The quorum for a shareholder meeting is determined as a percentage of total voting shares represented either in person or by proxy. Some companies consider a quorum to be as little as 10% of the voting shares. [The fund] believes that this threshold is too low. It allows companies to make decisions that require shareholder approval without consent from the owners of 90% of the shares.

The appropriate quorum size for a company depends on how widely held the company is. No company should have a quorum of less than 25%. Even at this level, companies can make decisions without the participation of three-quarters of the shareholders. [The fund] encourages companies with dominant shareholders to set higher quorum requirements.

Companies should not set higher quorum requirements for meetings in which there may be a vote on an issue that the board or management opposes. For example, the company should not set a higher quorum threshold for a meeting at which shareholders are seeking to replace a director.

- [The fund] will vote against proposals that would set the quorum requirement at less than 25% of voting shares.
- [The fund] will vote against proposals that would set a higher quorum requirement for meetings at which proposals will be made that are opposed by the board or management.

Shareholder-called meetings

Shareholders have a fundamental right to call special meetings, and this right should not be eliminated or abridged without the approval of the shareholders. If shareholders are required to own a certain percentage of shares before they can call a meeting, the percentage required should be one that shareholders could reasonably own given the size of the company.

- [The fund] will vote against proposals to limit or deny shareholders' right to call special meetings.
- [The fund] will vote for proposals to allow shareholders to call special meetings. If an ownership requirement is set, it should be reasonable for the size of the company.

Shareholder proposals

(See also "Voting for Directors," page 14.)

Shareholders should be permitted to bring proposals to the annual meeting. These proposals should be included on the proxy ballot, and proponents should be given adequate space in the proxy circular to explain the proposal. The board should implement any shareholder proposal that is approved by a majority of the shareholders.

Although it is unlikely that a proposal calling for shareholder proposals to be allowed would appear on the proxy ballot of companies that do not permit shareholder proposals, [the fund] would support such a proposal should it come up.

- [The fund] will vote for proposals to allow shareholders to bring proposals to the annual meeting where they are not permitted to do so.
- [The fund] will withhold votes from directors who fail to implement shareholder proposals that win majority approval.

Shareholder action by written consent

Some companies in some jurisdictions may seek the written consent of shareholders to take an action without holding a shareholder meeting or proxy vote. A company or shareholder sends a proposal to all shareholders asking for their consent to act on the proposal. Shareholders who agree return a signed consent card within a set time period, usually 60 days.

This procedure is intended to be used on non-controversial issues where the unanimous consent of shareholders is likely, in order to avoid the time and expense required to hold a special shareholder meeting. Either management or shareholders can use the procedure. In practice, it is rarely used.

Some companies seek to eliminate or restrict shareholders' right to act by written consent in order to prevent a takeover of the company. However, as with other takeover defences, this often protects management at the expense of shareholders.

Action by written consent has been used at companies that have a controlling shareholder to take action without the input of minority shareholders.

- [The fund] will vote against proposals to limit or deny shareholders' rights to take action by written consent, unless the company has a shareholder who controls more than 50% of the voting rights.
- [The fund] will vote for proposals to restore shareholders' right to take action by written consent, unless the company has a shareholder who controls more than 50% of the voting rights.

Shareholders' meetings

All shareholders should be given timely and sufficient information about the date, location, and agenda of shareholders' meetings and about the issues to be decided at the meetings. All shareholders should have access to proxies, and adequate time to consider and vote on the issues.

Participation in shareholders' meetings is a basic right of shareholders. Companies should encourage shareholders to attend annual general meetings. They can do this by making shareholders' expense and convenience primary considerations in deciding when and where to hold the annual meetings.

Some companies propose to hold their shareholders' meetings entirely by electronic means, without any shareholders being physically present. Virtual technology can supplement shareholders' meetings by making it easier for shareholders to participate in the proceedings. However, meetings held entirely by electronic means, without the opportunity for shareholders to attend in person, limit shareholders' participation and are not an adequate substitute for meetings in which shareholders can be physically present.

- [The fund] will vote against proposals to hold shareholders' meetings entirely by electronic means.

Shareholders' voting rights

(See also "Unequal Voting Rights and Dual Classes of Shares," page x.)

Companies in some jurisdictions are permitted to change shareholders' voting rights under certain circumstances. For example, shareholders of French companies may lose their voting rights if they hold bearer shares that have not been registered with approved brokers, or if the company believes the shareholder may have a conflict of interest. [The fund] believes that voting rights are an essential part of owning shares in a company and that the voting rights of shareholders should not be altered. In addition, all shareholders' votes should be given equal weight.

Shareholders often have no say in how a company alters or limits their voting rights. However, [the fund] will vote against a company's efforts to change or limit shareholders' voting rights whenever it has an opportunity to do so.

- [The fund] will vote against proposals that would limit or change shareholders' rights to vote their shares.
- [The fund] will vote for proposals to protect shareholders' voting rights.

OTHER CORPORATE GOVERNANCE ISSUES

Employee share-ownership plans

Employee share-ownership plans give employees a stake in the profitability of their company, create an additional incentive for good performance, and align employees' interests with the interests of shareholders. Employee share-ownership plans differ from executive share-based compensation in that they are open to all or the vast majority of a company's employees.

Most of these plans offer employees the opportunity to purchase shares or stock options at a discount. Discounts on option or share prices should be appropriate for the market, but no more than 20%, and less if the company's shares are highly diluted. These plans are subject to the same concerns about dilution as other share-based compensation plans. Shares acquired under these plans should be subject to a reasonable vesting period that will encourage employees to keep their shares but not penalize them should they need to sell the shares.

- [The fund] will vote in favour of employee share-ownership plans provided they discount options or shares by no more than 20%, include a reasonable vesting period, and conform to other relevant sections of these guidelines, such as dilution and loans for share purchases.

Approval of inter-company contracts

This proposal may appear on the ballots of companies that are required to seek shareholder approval for agreements between the company and its subsidiaries to transfer assets and liabilities. These proposed transfers are usually carried out for tax purposes.

- [The fund] will vote against the approval of inter-company contracts if the terms of the contract are not disclosed in enough detail for shareholders to assess how the transactions will affect the company.
- [The fund] will vote against the approval of inter-company contracts if they involve potential conflicts of interest.

CORPORATE SOCIAL RESPONSIBILITY

Financial managers' views on corporate social responsibility have changed considerably in the past decade. Environmental and social concerns were once seen as superfluous to business at best, and often as impediments to maximizing corporate profitability. But the investment community now recognizes that environmental and social issues have financial consequences and are part of the value of a company. As Peter Johnson, a director with PricewaterhouseCoopers, said "Corporate social responsibility is now a mainstream paradigm. It is applicable to all sectors and all businesses and during all stages of a company."[20]

Socially and environmentally responsible business practices are necessary for sustained profitability. In order to succeed in the long term, businesses need to treat employees, suppliers, and customers well, be environmentally responsible, and be responsive to the interests of the communities in which they operate. These considerations may provide reasons to exceed the minimum requirements for environmental or social performance set by law. [The fund's] proxy voting guidelines on social and environmental issues were developed on this basis. [The fund] is mindful of its ethical responsibilities as an institutional investor, responsibilities that obligate it to consider the consequences of its own investment decisions on society and the environment.

As a practical matter, proxy votes on sustainability issues differ from those on corporate governance issues in several ways. First, proposals on environmental and social issues are usually made by shareholders rather than by management. Second, the range of possible issues within corporate social responsibility is vast—certainly much larger than the range of topics covered by corporate governance. This makes it virtually impossible to anticipate and devise a guideline for all of the possible proposals that could be presented on a given proxy ballot. These guidelines address this problem by identifying a set of broad, internationally accepted standards and norms against which to assess corporate social responsibility proposals, augmented by specific guidelines for common types of proposals.

As stated earlier, if an issue on a proxy ballot is not specifically addressed by these guidelines, [the fund's] voting decision will be guided by its commitment to the long-term interests of its beneficiaries. Pension fund fiduciaries must keep in mind their funds' commitment to providing pension benefits many decades into the future and exercise their proxy voting rights in a way that will maintain the social, economic, and environmental structures upon which long-term investment returns are based.

GENERAL GUIDELINES

International standards and norms

International law and standards provide useful guidance for evaluating socially responsible business practices. [The fund] will be guided in its proxy voting by the principles that are expressed in the following international standards.

- The UN Universal Declaration of Human Rights (http://www.un.org/Overview/rights.html)
- The International Labour Organization's Fundamental Principles and Rights at Work (http://www.ilo.org/public/english/standards/index.htm)
- The International Labour Organization's Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (http://www.ilo.org/empent/Publications/WCMS_094386/lang--en/index.htm)
- The Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises (http://www.oecd.org/corporate/mne)
- The UN Declaration on the Rights of Indigenous Peoples (http://www.un.org/esa/socdev/unpfii/documents/DRIPS_en.pdf)

- The International Finance Corporation Performance Standards on Environmental and Social Sustainability http://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+sustainability/publications/publications_handbook_pps
- The UN Global Compact (http://www.unglobalcompact.org)
- The Global Reporting Initiative Guidelines (http://www.globalreporting.org)
- UN Guiding Principles on Business and Human Rights (http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf)
- The Voluntary Principles on Security and Human Rights (http://www.voluntaryprinciples.org)
- The Equator Principles (http://www.equator-principles.com)

The primary responsibility for determining what a company should do to be socially responsible rests with management. However, when a company's actions violate international standards or expose the company to increased risk, fiduciaries have a responsibility to protect the value of their investments.

- In general, [the fund] will vote for shareholder proposals that call on companies to adhere to principles established in these international standards.

Reports on social and environmental issues

Corporations have a responsibility to disclose to their shareholders the potential liabilities of their operations, including the risks associated with social and environmental aspects of their operations. EU companies with more than 500 employees must include in their management reports disclosures on environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors.[21]

This disclosure may be included in sustainability reports with other information on the company's social and environmental performance. Sustainability reports should be made in the normal course of reporting to shareholders. [The fund] recommends the Global Reporting Initiative guidelines for creating sustainability reports.[22]

Companies may also integrate information on their social and environmental performance into their annual reports. The GRI includes guidelines for integrated reports. [The fund] supports efforts to integrate sustainability reports and traditional financial reports, as long as the resulting reports are comprehensible and provide the same level of information as separate sustainability and financial reports would provide.

- [The fund] will vote for proposals to provide shareholders with sustainability reports.
- [The fund] will vote for proposals for companies to issue integrated sustainability and financial reports, as long as the integrated reports can be understood and provide as much information as separate sustainability and financial reports would provide.
- [The fund] will vote for proposals that ask companies to report to shareholders using the Global Reporting Initiative Guidelines.

Companies are often asked to report on specific environmental or social issues, including the risks associated with particular operations, conditions, or practices and/or plans to mitigate those risks. Examples of this type of proposal are requests for reports on the risks of failure to obtain the consent of local communities, the diversity of the company's managerial staff, or a company's efforts to reduce its greenhouse gas emissions. In general, [the fund] will support these proposals unless the information requested is proprietary, would be prohibitively expensive to produce, or is already easily available, such as information contained in a sustainability report.

- [The fund] will vote for proposals to provide shareholders with reports related to the specific social and environmental aspects of their operations, including related risks and liabilities and efforts to mitigate those risks, provided the information is not already easily accessible to shareholders. Disclosure of this information should not require companies to disclose confidential or proprietary information, and the costs of providing the information should be reasonable.

LABOUR RIGHTS

A company's employees are stakeholders in the company and they make an essential contribution to the company's success.

The International Labour Organization's Fundamental Principles and Rights at Work and the OECD's Guidelines for Multinational Enterprises spell out certain basic labour rights; these are described in more detail in the subsection "Labour Practices" page 48, under "International Operations," page 47. [The fund] encourages companies to adopt these standards as a minimum commitment to labour rights in all of their operations.

Workplace practices

Companies whose employees are satisfied with their work conditions are more likely to enjoy greater customer satisfaction, higher productivity and greater profitability.[23] Employers who provide employee training, employment security and a supportive work environment are more likely to enjoy improved productivity and long-term financial gain. [The fund] encourages companies to adopt such policies because they contribute to long-term profitability.

- [The fund] will vote for proposals that ask companies to report on the quality of their workplace practices and on their efforts to improve the quality of their workplaces, including reports on diversity in their workforce.
- [The fund] will vote for proposals that ask companies to establish a board committee to examine and report on its workplace practices unless doing so would be unduly burdensome or would not improve the workplace or benefit shareholders in the long term.

Layoffs and reductions in force

One aspect of treating employees as stakeholders and partners is avoiding layoffs except as a last resort. Layoffs can damage a company's reputation, employee morale, and community relations, and they tend not to be beneficial to the company in the long term.

[The fund] recognizes that layoffs may be unavoidable under some circumstances. However, some layoffs are initiated because of the perception that they are a quick way to cut costs and boost profits. Research conducted since the mid-1990s has shown that companies that lay off employees for this reason only see an improvement in their financial performance in the very short term and hurt their profits in the longer term.[24]

- [The fund] will assess proposals concerning layoffs on a case-by-case basis. This assessment will include consideration of the likely consequences of any proposal for the employees, local communities, and long-term profitability of the company.
- [The fund] will vote for proposals to implement programs to assist laid-off workers, provided the costs of the programs are reasonable.

Discrimination in employment

(See "Labour Practices," page 48.)

All jurisdictions in Canada and the United States have laws prohibiting discrimination in employment on the basis of race, religion, national origin, ancestry, sex, age, and physical disability. Many jurisdictions also have laws prohibiting employment discrimination on the basis of sexual orientation and promoting pay equity and affirmative action. [The fund] encourages companies to comply with the International Labour Organization's standard on non-discrimination.

See the earlier section "Workplace Practices," page 43, for the guideline on workforce diversity reports.

- [The fund] will vote for proposals to improve diversity and equity in the workplace, as long as those plans do not set arbitrary or unreasonable goals or require companies to hire people who are not well-qualified for their positions. It will assess these proposals case by case.
- [The fund] will vote for proposals to prohibit discrimination in employment, including proposals to expand or clarify anti-discrimination policies.
- [The fund] will vote against proposals that would exclude any group of people from policies against employment discrimination.[25]

Workplace health and safety

In 2013 approximately 242,000 Canadians were compensated for injuries at work, and more than 900 Canadians died as a result of their work.[26] In addition to the human costs, work-related injuries and illnesses are expensive for companies. The costs can include lost work time, damage or loss of product and raw materials, repairs to equipment, additional wages to replace the injured worker, production delays, investigation time, fines, loss of contracts, legal costs, lowered productivity or morale, loss of business reputation, increased insurance and workers' compensation premiums, and loss of investor confidence. A poor safety record can also affect a company's share price and its attractiveness to investors.[27] A good workplace safety record can give companies a competitive advantage.

Companies should disclose to their shareholders detailed information on the key health and safety risks they face, such as the rates of injury, illness, and accidents, including the potential costs of these risks where it is appropriate to estimate them. Reports should also include the steps the company is taking to mitigate these risks. If companies have had health and safety problems in the past, a report on their progress in improving health and safety conditions is also appropriate.

- [The fund] will vote for proposals that ask companies to report on their occupational health and safety policies, practices, risks, estimates of the cost where possible, and their progress on improving conditions, unless these reports are already easily available to shareholders.

- [The fund] will vote for proposals that ask companies to take steps to reduce their risks of workplace illness and accidents, including appointing a committee responsible for health and safety.
- [The fund] will vote for proposals to include well-considered health and safety performance criteria in setting executive compensation. See, "Executive performance and corporate social responsibility", page 27.

ANIMAL WELFARE

Proposals concerning animal welfare may ask companies for reports on how they treat animals in their operations, or on how their treatment of animals affects the environment and human health. Proposals may also ask companies to change the way they treat animals.

[The fund] supports the humane treatment of animals. We support well-considered proposals for reports on animal welfare; these are covered by the guideline on reports on social and environmental issues on page 42. Proposals that ask companies to change the way they treat animals are necessarily more varied and must be considered case by case.

- [The fund] will vote case by case on proposals that ask companies to change the way they treat animals, taking into consideration the costs and benefits of making the change and the effect the proposed change will have on the company and its stakeholders in the long term.

RELATIONSHIPS WITH COMMUNITIES

Obtaining approval from local communities—social license to operate

The phrase "social license to operate" refers to companies obtaining the support of communities who may be affected by mines, pipelines, or other projects before proceeding with the projects. This includes the free, prior, and informed consent of indigenous peoples. Obtaining a social licence to operate often requires companies to take steps to secure community support that go beyond what is required by law. Proposals concerning social licence to operate are usually filed with extractive-industry companies, but the concept could also apply to other industries.

Companies that proceed with projects without obtaining and maintaining local consent may face protests, sabotage, boycotts, negative publicity, and falling share prices. Some oil and mining companies have had to abandon projects because of local opposition, after investing hundreds of millions of dollars.[28] Companies that fail to obtain local consent may also violate laws and/or international agreements, particularly those designed to protect the rights of indigenous peoples.

- [The fund] will vote for reasonable proposals that ask companies to commit to meaningful and ongoing consultation with local communities affected by their operations.
- [The fund] will vote for reasonable proposals that ask companies to obtain and maintain free, prior, and informed consent of indigenous people.

Political contributions and positions

[The fund] discourages companies from making political contributions. If a company chooses to engage in political activity, it should be transparent about these activities.

There are many reasons for this. Political contributions often imply some degree of influence over the recipients, even if this is not explicit. The policy of avoiding political contributions prevents the appearance of a quid pro quo and possible scandal if politicians or governments adopt policies favourable to the company. The policy also prevents political parties, candidates, or other organizations from exerting pressure on companies to contribute to political campaigns.

With regard to other political activity (e.g. lobbying, advertising, funding political activity by outside organizations), there are times where corporations may represent their interests in policies and legislation which concern their business. However, there are also instances in which corporations have persuaded governments to adopt policies that are favourable to them but detrimental to the public good, and this has created widespread public distrust of corporate influence in the political process. The resulting erosion of public trust in business and government is detrimental to both.

There may be conflicts between the political positions of companies and their shareholders or between the companies and positions of the organizations that receive their contributions and claim to speak for them. There may also be discrepancies between companies' stated policies and the political positions they support. Finally, corporations that use their resources to influence public policy can distort the democratic process by having more input into policy-making than ordinary citizens have. For these reasons company lobbying and other political activity must be fully disclosed to allow investors to identify appropriate activity and assess any risks incurred.

If companies choose to make political contributions or engage in direct or indirect political activities, they should be transparent about their activities. They should disclose to shareholders all of the activities they engage in to influence public policy, report on the full amounts spent and what the money was spent on, and explain the business reasons for engaging in these activities. This disclosure should include companies' memberships in trade associations and other organizations that engage in political activities on behalf of their members.

- [The fund] will vote for proposals to ban corporate political contributions, including non-monetary contributions.
- [The fund] will vote against proposals to make corporate political contributions.
- [The fund] will vote for proposals to require companies to disclose the amounts of, rationale for, and recipients of any monetary political contributions and non-monetary contributions to individuals or organizations to influence public policy, as well as company policies and oversight mechanisms related to political activity, provided this can be done without undue expense and that the reports are not already easily available to shareholders.

Predatory lending

Predatory lending is the practice of advertising and making loans in ways that obscure the full cost of borrowing. Predatory lending exposes corporations to uncollectible debt, litigation, and penalties from regulatory agencies. These practices pose a significant risk to the lender, the borrower, and entire economies.

- [The fund] will vote for proposals to require companies to develop and enforce policies barring predatory lending practices, and to report to shareholders on the implementation of those policies, unless such reports are already easily available to shareholders.

Reincorporation, tax evasion and tax avoidance

(See also "Reincorporation," page 37.)

Concerns about companies' avoidance of taxes has expanded to include a broad range of strategies that multinational corporations use to shift their profits to low-tax or tax-free jurisdictions. The OECD calls this "base erosion and profit shifting" or BEPS. Most of the OECD's efforts to address this problem are directed to governments, because mismatches in their tax laws and treaties make tax avoidance possible.29

Shareholders have an opportunity to vote on this issue when companies reincorporate in a new jurisdiction in order to avoid paying taxes or to minimize the amount of tax they pay. Sometimes these changes in jurisdiction come about as part of a merger or acquisition. Shareholders must usually approve companies' reincorporation or change in control, which gives them an opportunity to object tochanges that are motivated by aggressive tax avoidance. [The fund] agrees with the OECD that aggressive tax avoidance gradually undermines the economies of all countries. Reincorporating in low-tax or tax-free jurisdictions may foster a "race to the bottom" that undermines the public sector, and poses financial and reputational risks to companies that use these strategies.[30]

- [The fund] will vote against proposals to reincorporate, including mergers or acquisitions, if it is apparent that the company is reincorporating to avoid taxes, unless there is a compelling reason to vote for it.
- [The fund] will vote for proposals that ask companies comply with policies or guidelines on tax avoidance and base erosion promoted by the OECD.

DANGEROUS PRODUCTS AND PRODUCT LIABILITY

Although no responsible business would intentionally cause public harm, some products prove to be clearly or potentially dangerous. In these circumstances, the products in question become a potential liability to their producers, dealers, and shareholders. [The fund] encourages companies to take a precautionary approach to products that could cause harm by conducting their own studies of the product and following the progress of independent research.

If companies use processes or substances in their operations that have been shown to be hazardous, [the fund] encourages those companies to develop and implement plans to end the use of those processes or substances. Proposals asking companies to report on the safety of their products or operations are covered by the guideline "Reports on Social and Environmental Issues," page 42.

- [The fund] will vote for proposals asking boards to establish a committee to examine and report on issues related to product safety, unless doing so would not benefit the company's shareholders or other stakeholders in the long term.
- [The fund] will assess proposals to end the use of a process, or the production or sale of a product or substance, on a case-by-case basis. This assessment will include the potential hazards and liabilities associated with the product, substance, or process, existing or

prospective regulation of the product, substance, or process and the costs of eliminating it.

Genetically modified organisms

Shareholder proposals concerning genetically modified organisms (GMOs) normally ask companies to report on their use of GMOs, to label their products that contain GMOs, or to stop producing or using GMOs altogether. The contamination of non-modified crops by the genetic material of transgenic crops has resulted in lawsuits, regulatory sanctions, and product recalls costing billions of dollars.[31] Some modified crops have been commercial failures. Food and other consumer products containing GMOs face market rejection and regulatory restrictions due to consumer concerns about their safety.[32] The use of genetically modified crops also results in more use of pesticides and herbicides, which causes more pollution and may increase companies' environmental liability.

Consumers have demanded that products containing GMOs be labelled as such. Labelling is mandatory in some jurisdictions, and mandatory labelling is supported by large numbers of consumers in other jurisdictions.[33] These trends make it likely that companies will enjoy greater access to markets, a better reputation, and greater consumer satisfaction if they label their GMO products.

[The fund] believes that companies should disclose the risks presented by their use of GMOs.

- [The fund] will vote for proposals that ask companies to label their products that contain GMOs.
- [The fund] will assess proposals to stop producing or using GMOs on a case-by-case basis. This assessment should include careful consideration of the potential liabilities from the GMOs at issue, the anticipated market for products containing GMOs, the costs of market failure, the findings and status of current independent research on the safety of the GMOs, and any issues that may arise related to insurance.

ENVIRONMENTAL ISSUES

Companies' environmental performance has a material effect on their profitability. Environmental damage risks not only harm to public health and the environment, but also legal liability, remediation costs, the costs of unplanned and possibly significant changes in operations, and a damaged reputation. Sound environmental practices, such as reducing energy use, cutting greenhouse gas emissions, or recycling can improve a company's financial performance and its reputation as well as reducing its environmental footprint.

Companies can manage their environmental performance by using the precautionary approach, described in greater detail in the United Nations Global Compact. The UN Global Compact also includes environmental principles that will help corporations to be environmentally responsible. [The fund] will generally support companies' efforts to implement these or comparable principles.

- [The fund] will vote for proposals that ask companies to adopt the UN Global Compact, or another set of environmental standards as long as these standards are at least as stringent as those in the UN Global Compact.
- [The fund] will vote on proposals that ask companies to improve their environmental performance case by case. This includes proposals to take specific actions to improve the company's environmental performance. In general, [the fund] will support these proposals as long as the action requested can realistically be achieved by the company, does not hurt the company's long-term performance, and is not detrimental to the interests of its stakeholders.

Climate change

The consequences of climate change are material risks that investors and businesses of all kinds must address. Models of climate change based on a continuation of the world's current production of greenhouse gases predict financial disasters, including shortages of energy, reduced food production, increased water scarcity, frequent natural disasters and rising ocean levels.[34]

Companies are also coming under increased pressure from their investors to reduce their greenhouse gas emissions. Nearly 350 institutional investors from all over the world have signed the Global Investor Statement on Climate Change, which includes support for carbon pricing and low-carbon investments.[35] Leaders of 196 countries worldwide recently adopted an agreement and general plan to limit the global temperature increase to 2°C above pre-industrial levels. The mechanisms to deliver on these commitments are not yet clear, but companies will likely be required to reduce their own greenhouse gas emissions. Companies in high-carbon-emissions industries may need to consider long-term business plans and capital expenditures to adapt to a lower-carbon economy and/or future demand curves for fossil fuels.

Although no single company's actions can reduce global climate change, greenhouse gas reductions are still beneficial. Some of the techniques for reducing emissions, such as lowering energy use, reduce the company's costs in the long term. These efforts make the company more cost-effective, lower its exposure to climate change risks, and

position it to trade carbon credits. [The fund] will generally support proposals for companies to reduce their emissions, unless the net result would be detrimental to the company and its stakeholders in the long term.

- [The fund] will vote for reasonable proposals calling for companies to improve oversight, management and reduction of their greenhouse gas emissions.
- [The fund] will vote for reasonable proposals that encourage boards and management to disclose steps they are taking to address climate-related risks in business planning and/or capital expenditures.

Hydraulic fracturing

Hydraulic fracturing (sometimes called fracking) is a method for extracting natural gas and oil from underground shale formations by injecting a mixture of water, sand, and chemicals into the shale at high pressure.

The potential returns from ydraulic fracturing are considerable, but so are the potential risks. The process requires enormous amounts of water - typically millions of gallons litres per well - which can deplete local water supplies. The wells can leak methane, a highly potent greenhouse gas, and the process uses toxic chemicals that can leak into the air, water, or soil around extraction and waste disposal sites. Although energy companies claim that the process can be done safely, hydraulic fracturing has been associated with contaminated air, soil, and groundwater.[36] Concerns about the effects of hydraulic fracturing have led some jurisdictions to ban the process or institute moratoria on it. Companies that have used hydraulic fracturing have been fined and sued. Public distrust of fracking and of companies that use it remains high.

To date, most of the proposals concerning hydraulic fracturing have asked companies for reports on the risks of the procedure and on the company's efforts to mitigate those risks. Companies have also been asked to report on the chemicals used in hydraulic fracturing. These reports are covered by the guideline "Reports on Environment and Social Issues," page 42.

Companies are likely to benefit from efforts to lower the environmental risks associated with hydraulic fracturing. Proposals that ask companies to disclose any litigation or penalties they face as a result of their hydraulic fracturing operations also benefit shareholders because this is material information about costs to the company and potential damage to the company's reputation. These reports can give the company an opportunity to demonstrate what it has learned, show how it has improved its operations, and repair or enhance its reputation.[37]

- [The fund] will vote for proposals that ask companies to improve the sustainability of their hydraulic fracturing operations, provided the proposal will not be detrimental to the company or its stakeholders in the long term.
- [The fund] will vote for proposals that ask companies to disclose any litigation or, penalties or similar risks they face from hydraulic fracturing or related operations.

Water use management

Water scarcity is a growing problem that affects business in many sectors. The risks of failing to manage water use and water resources are considerable. They include the loss of water supplies, liability for the depletion, contamination or destruction of local water supplies, the loss of local license to operate, and damage to the company's reputation.

The cost of water is often lower than its value. Companies can begin to manage water use responsibly by assessing the value of water to a business's operations, instead of focusing solely on how much it costs. As with other potential risks, businesses should disclose to their shareholders the company's exposure to water-related risks and how it manages those risks. The CDP questionnaire provides a way for companies to report on these issues. [The fund] recommends that companies use the CDP for reporting on their use of water and related risks.[38]

Proposals asking companies to report on their use and management of water are covered by the guideline "Reports on Social and Environmental Issues," page 42. [The fund] will support well-considered proposals for better management and conservation of water.

- [The fund] will vote for proposals that ask companies conserve water or to improve how they manage their use of water, provided the proposal would not be detrimental to the company or its stakeholders in the long term.
- [The fund] will vote for proposals for greater disclosure of companies' potential risks related to their use of water, and their plans to address those risks.

INTERNATIONAL OPERATIONS

International operations are highly complex; they demand that corporations reconcile differences in legal regimes, cultural values and practices, and consumers' and workers' interests. The OECD, of which Canada is a member, has established the Guidelines for Multinational Enterprise, which set standards for international operations in labour, the environment, consumer protection, fair competition, science and

technology, and taxation. These guidelines were developed in cooperation with representatives from business, labour, and the governments of OECD member countries. [The fund] recommends that companies adhere to the OECD Guidelines for Multinational Enterprise.

All of [the fund's] guidelines on environmental and social issues apply equally to companies' international and domestic operations. International operations also raise some additional issues, which are addressed here.

Labour practices

One appeal of moving production overseas is that doing so allows corporations to take advantage of lower wages in some countries. Unfortunately, some corporations have sought an unfair competitive advantage by lowering their labour standards for overseas operations. As a result, multinational corporations and their host countries have been perceived as being in a labour-standards race to the bottom—promoting child labour, forced labour, long hours at lower-than-subsistence wages, and dangerous working conditions. When a company becomes associated with poor labour practices, the result is often negative publicity, consumer boycotts and divestiture or avoidance by institutional investors.

To ensure that consistently high standards are used in global employment practices, [the fund] encourages companies to adopt the labour standards in the OECD's Guidelines for Multinational Enterprise.[39] The guidelines include

- respect for employees' freedom of association, including the right to organize, hold meetings, and bargain collectively without coercion or interference;
- the abolition of forced labour such as indentures or labour as punishment for the expression of political views;
- an end to discrimination in employment based on race, creed, colour, political opinion, social origin, or sex. This includes equal access to employment and training, and an end to discrimination in working conditions. It also includes equal pay for men and women for work of equal value;
- the effective abolition of child labour. There are situations in which children must work in order to survive. The UN Global Compact has helpful guidelines for companies regarding child labour;[40] and
- ensuring occupational health and safety.

- [The fund] will vote for proposals that ask companies to adopt and comply with the labour standards of the OECD Guidelines for Multinational Enterprise, the International Labour Organization's core labour standards, or employment standards or agreements that are consistent with those guidelines.
- [The fund] will vote for proposals that ask companies to provide shareholders with independently verified reports on their progress in implementing the International Labour Organization's core labour standards, the OECD Guidelines for Multinational Enterprise, or equivalent standards, unless this information is already easily available to shareholders.

Human rights

Conducting business in a country with a weak human rights record can present a company with operational challenges, lawsuits, boycotts or divestment campaigns, and damage to its reputation, even if the company tries to distance itself from the human rights abuses.

In 2011 the United Nations Human Rights Council adopted the Guiding Principles on Business and Human Rights ("the UN Guiding Principles"), which set out a framework for companies to respect human rights. The OECD's Guidelines for Multinational Enterprises also include human rights.

Human rights cases currently before Canadian courts raise the possibility that these international standards may create a duty of care for Canadian companies operating in other countries and their suppliers. This duty of care would make companies legally responsible for human rights violations committed by companies in their supply chains.[41] Other jurisdictions have enacted laws that make companies responsible for human rights violations in their supply chains.[42] Adopting and implementing the UN's Guiding Principles, the OECD's Guidelines for Multinational Enterprises, and supplier codes of conduct can help companies avoid being associated with human rights abuses. Companies may also have to comply with human rights reporting requirements in the jurisdictions where they are incorporated or are listed.[43]

- [The fund] will vote for proposals to require companies to adopt and/or comply with international human rights standards, including the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles.
- [The fund] will vote for proposals that ask companies to consult with stakeholders on the effects of their operations on human rights, including organizations with expertise in human rights.
- [The fund] will assess proposals that ask companies to cease operations in countries with human rights abuses

case by case, taking into account the potential for harm or benefit to the people of the country in question and the effects on the company in the long term.

Operations in zones of conflict

Companies that operate in conflict or high risk areas face serious risks, including harm to their personnel, the appearance of being aligned with parties to the conflict, and possible litigation. They should adopt and implement policies, including enhanced due diligence, to ensure they are not contributing to conflict.

[The fund] encourages corporations that choose to operate in conflict areas to use the UN Guiding Principles cited in the previous section, the OECD's "Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones", [44] and the UN "Global Compact-UN PRI Guidance on Responsible Business in Conflict-Affected and High-Risk Areas"[45] for guidance on protecting human rights in areas of conflict.

- [The fund] will vote for proposals that ask companies operating in conflict zones to establish and implement policies to protect human rights and to ensure that they are, in fact, protecting those rights.
- [The fund] will vote for proposals that ask companies to monitor compliance with those policies and to provide shareholders with independently verified reports on their adherence to those policies, provided these reports are not already easily available to shareholders.

Freedom of expression and electronic censorship

Some countries use software or the records of cell phone companies and internet service providers to monitor their citizens, enforce censorship, or suppress dissent. In November 2005, a group of 26 institutional investors from the United States, Canada, and Europe issued the "Joint Investor Statement on Freedom of Expression and the Internet," [46] calling on businesses to adopt and publicize codes of conduct that ensure they are not being used to stifle free expression or commit human rights violations.

[The fund] recognizes that the right of free expression is not universally accepted and that the appropriateness of limits on free expression is hotly debated. Nevertheless, the protection of basic human rights, including freedom of expression, is necessary for sound, long-term investment. Companies that allow their products or records to be used for censorship or surveillance, or that turn a blind eye to the uses to which their products or data are put, may expose others to human rights abuses, expose themselves to liability for human rights abuses and put their investors' confidence at risk.[47]

- [The fund] will vote for proposals that ask companies to adopt codes of conduct that include obligations to uphold freedom of expression and to prevent the companies' products or services from being used to violate the freedom of expression.
- [The fund] will vote for proposals that ask companies to report to shareholders on their progress in implementing these codes of conduct or in achieving compliance from their contractors, provided these reports are not already easily available to shareholders. This includes proposals that ask companies to establish board committees to examine and report on their practices and codes of conduct related to the protection of freedom of expression.

Monitoring of foreign contractors

A large portion of overseas manufacturing is done through contracting and subcontracting, rather than at facilities owned directly by a company. This makes it possible for a company's products to be produced in conditions that violate international standards, with all of the attendant risks. Companies must monitor their contractors' operations and insist on operating practices that conform to international standards as a condition for awarding contracts. However, the number and diversity of contractors involved makes insisting on international standards and enforcing them a complex matter.

For this reason, [the fund] encourages companies to establish a monitoring process that includes independent verification of contractors' compliance with labour and environmental standards. [The fund] recommends involving local religious, human rights, and workers' organizations that are independent and well-respected in the monitoring process, and using incentives rather than premature termination of contracts to encourage suppliers to raise their labour and environmental standards.

- [The fund] will vote for proposals that ask companies to adopt due diligence practices, to evaluate their contractors' operations, and to use qualified, independent monitors to assess their contractors' adherence to labour and environmental standards.

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- Canada Pension Plan Investment Board
- Christian Brothers Investment Services
- State of Connecticut, Office of the Treasurer
- Domini Social Investments LLC
- The Episcopal Church
- Florida State Board of Administration
- General Board of Pension and Health Benefits of the United Methodist Church
- Hermes Fund Managers Limited
- Hospitals of Ontario Pension Plan
- Institutional Shareholder Services Inc.
- NEI Investments
- City of New York Board of Education Retirement System, City Employees' Retirement System, Fire Department Pension Fund, and Police Department Pension Fund
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