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SHAREHOLDER ASSOCIATION for RESEARCH & EDUCATION

March 26, 2021

Corporations Canada
Innovation, Science, and Economic Development Canada
235 Queen Street, Floor 7
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Via email: ic.corporationscanada.ic@canada.ca

To whom it may concern;

We are writing to comment on the development of regulations related to amendments to the *Canada Business Corporations Act* (CBCA) enacted under Bill C-97 *An Act to implement certain provisions of the budget tabled in Parliament on March 19, 2019 and other measures,* concerning executive compensation and the well-being of employees, retirees and pensioners.

SHARE is a leading Canadian not-for-profit organization providing responsible investment services, research and education. We work with a growing network of more than a hundred institutional investors with more than $75 billion in assets, helping them to become active owners and to develop and implement responsible investment policies and practices.

We have a particular interest in the maintenance and growth of a strong retirement security system for Canadians, as well as responsible corporate governance that protects pension investors as share owners.

These two objectives are mutually-supporting. We do not believe that shareholders benefit in the long-term from corporate governance and executive compensation practices that prioritize executive and even investor enrichment over other important stakeholders like a company's workers and retirees.

We offer the following comments in response to the specific questions that ISED has raised. These comments do not touch on the whole range of retirement security options that we believe should be pursued by the federal (and provincial) governments, but are intended to assist with the current review of specific proposed regulations under the *Canada Business Corporations Act*.

Issue A: prescribing the corporations that are subject to the new obligations

We agree that the new obligations should apply to distributing corporations, defined as publicly-traded corporations incorporated under the *Canada Business Corporations Act* (CBCA). However, we urge the Government of Canada to review the application of similar rules to other federally-regulated corporate vehicles such as Schedule I banks under the *Bank Act*.

Issue B: prescribing the definitions of "members of senior management", "retirees" and "pensioners"

The definition of "members of senior management" should include the entire Board of Directors rather than just the Chair and Vice Chair, particularly as the definition will be used in calculation of diversity disclosures. In addition, the definition should include any Named Executive Officers as opposed to just the Chief Executive Officer and the Chief Financial Officer, since current corporate structures may include many others in the C-suite and these C-suite level positions are known to be important spring-boards to board-level inclusion for women and racialized individuals.

We have no comment on the other definitions, as proposed.

Issue C: prescribing the time and manner for disclosing the results of the say-on-pay vote

In general, we agree with the proposed manner for disclosing the results of the "say on pay" vote. However, we believe there should be additional clarity on the disclosure of the vote results, specifically that vote results should be disaggregated by percentages of "insider" votes versus other votes, with the definition of "insider" consistent with the *Ontario Securities Act*, RSO 1990, c S.5, Section 1(1). This will assist in demonstrating the extent of *independent* shareholder approval of the board's approach to executive compensation by separating out the votes of board members, executives and others that might reasonably be expected to support management's approach, furthering engagement between independent shareholders and boards related to the issue.

We also believe vote results should be reported within four days of the event, similar to requirements for reporting issuers under the Securities Exchange Commission's 8-K reporting regulations, or, at minimum, within ten days of the

date on which the vote takes place (consistent with reporting of material changes under Section 75(2) of the *Ontario Securities Act*).

Distributing corporations should be expected to post vote results using the common SEDAR system for issuers, and not just to post results on their own website.

Issue D: prescribing the information that needs to be disclosed to shareholders about the recovery of incentive and other benefits

We support the inclusion of the required information on the presence and substance of a clawback policy at the company's annual meeting (and, in the case of distributing corporations, this material should be disclosed in the company's Management Information Circular/proxy circular well in advance of the annual meeting).

A clawback policy should (a) recover incentive compensation in the event of a violation of a company policy relating to non-compliance with a law or regulation that causes significant financial or reputational harm to a company, including supervisory failures, and (b) require disclosure to shareholders in the proxy statement about such recoveries without violating privacy laws

We therefore suggest the following amendments to the proposed disclosures:

1. *The disclosures should clarify whether the clawback policy applies solely to conduct that results in material financial restatements, or includes other misconduct (e.g. related to violations of the Company's Code of Conduct or other policy governing employee conduct which results in significant reputational or financial harm related to non-compliance), or to other legal or regulatory liability.*

   The scope of action should be determined by each board's policy, but identifying this as a criterion for disclosure may help to guide boards in developing a policy that is sufficiently broad so as to capture misconduct that, while not necessarily resulting in restatements, is seriously damaging to the company and its shareholders.

2. *The required disclosures should include a) whether legal and/or compliance costs are explicitly excluded from financial performance metrics used in the corporation's compensation framework, and if they are*

excluded, why such exclusion is warranted, and b) a breakdown of the legal and compliance costs, including any settlements made.

Non-GAAP performance metrics like "Adjusted Earnings Per Share" are being used more and more frequently by corporations to re-define financial performance in a manner that is more beneficial to executives than standard accounting metrics might be. While the current consultation does not address this issue specifically, it is worth addressing the question of legal compliance and accountability in the context of a clawback policy specifically. Compensation metrics communicate behavioral expectations to employees and adjusting metrics for items that are related to the company's core business can suggest a lack of accountability. Even worse, insulating executives from accountability for fines and legal settlements that resulted from their decisions works in direct opposition to the purpose of a clawback policy, which is meant to ensure accountability for one's actions.

In recent weeks, for example, 48% of shareholders at the global pharmaceutical company AmerisourceBergen voted against the company's executive compensation package because the firm excluded the cost of a record-breaking US$6.6 billion settlement charge related to opioid drug lawsuits from its non-GAAP metric of "adjusted operating income", turning a US$5.1 billion operating loss into a US$2.2 billion profit, and thereby allowing a US$14.3 million payout to the CEO – up 26% from the previous year.[1]

Although boards remain responsible for the choice of metrics used to define performance, and may choose to exclude some items from performance metrics for specific reasons, as a fundamental matter of accountability, the board should be required to explain to shareholders why fines and legal costs are being excluded in each instance.

3. *The required disclosures should also include information about incentive pay deferral policies, if any, their scope and application.*

   Bonus deferrals allow accurate assessment of risks taken during a particular performance measurement period that could have affected performance on the financial metric(s) employed to calculate bonuses, and implementation of appropriate bonus deferrals allows a company to

[1] See https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-amerisourcebergen-mar-2021.pdf

recoup incentive-based pay pursuant to its clawback policy. In this sense bonus deferral policies are a natural complement to an effective clawback policy, simplifying the process of retrieving pay that should not, ultimately, have been awarded. It is particularly useful in the context of insolvencies that may affect employees' retirement savings, as recouping pay that has already been awarded is very difficult after the fact and usually requires litigation (thus reducing the amount available to pay retirees).

Bonus deferral is widely used in the banking industry, where overly risky behavior generating short-term profits but longer-term losses was widely viewed as contributing to the financial crisis. In 2009, the Financial Stability Board, which coordinates national financial authorities in developing strong financial sector policies, adopted *Principles for Sound Compensation Practices* and implementation standards for those principles, including bonus deferral. Deferral is "particularly important" because it allows "late-arriving information about risk-taking and outcomes" to alter payouts and reduces the need to claw back compensation already paid out, which may "fac[e] legal barriers," in the event of misconduct. Banking supervisors in 16 jurisdictions, including Canada, have requirements or expectations regarding bonus deferral.[2]

Deferral policies were also the subject of a recent working group of institutional investors and fifteen major pharmaceutical industry companies which developed a set of principles for bonus deferrals. After the *Incentive Principles* were developed, compensation committees of three companies, Bristol Myers Squibb, CVS Health, and Walgreens, voluntarily took steps to align their plans with the intent of the Principles, and others are in the process of doing so.

4. *ISED has proposed that corporations be required to disclose information on recoveries made, if any, in the previous fiscal year. This should be amended to include information on the* reasons *for said recoveries (consistent with the clawback policy) and the* amount *of the recovery made. While information may be given on the amount recouped or the number of incidents in the aggregate to avoid privacy violations, reasons linking back to violations of a company's code of conduct or regulatory or legal rules would benefit investors.*

[2] https://www.fsb.org/wp-content/uploads/P170619-1.pdf

Issue E: prescribing the information that needs to be disclosed to shareholders about the well-being of employees, retirees and pensioners

While we support the concept of adoption of a policy regarding the well-being of employees, retirees and pensioners, in our experience asking for a general policy without some indication of expectations (ideally in the form of direct regulated disclosure, or at minimum in the form of guidance on types of disclosure that may be expected) often leads to boilerplate policy adoption without depth or substance, and the policy's subsequent implementation is hampered by its non-specificity.

We believe a well-being policy can be better implemented if the required disclosures are more specific. This will both give substance to the policy internally and, importantly, will provide shareholders with consistent and comparable information which will assist with shareholder-company dialogue and accountability. A lack of guidance may negatively affect the quality of information provided, thus increasing agency problems between the management and its shareholders.

Specifically, the required disclosures should include:

1. A description of how the policy applies to different categories of employees, e.g. direct, contracted and franchised employees.
2. The funded status of any company pension plan(s), expressed on a going concern basis and a solvency basis;
3. In the event that one or more company pension plans are underfunded in the reporting period, the ratio of funded status of each company pension plan to executive compensation at the end of the reporting period, based on the Canadian dollar value of any underfunding compared to the total calculated value of salary and short- and long-term incentive compensation awarded to the Chief Executive Officer;
4. The number of full time, part-time and contingent employees at the company during the current reporting period, disaggregated by "designated groups" already identified in the CBCA;
5. Key occupational health and safety process metrics used in evaluating performance and the results for the current reporting period;
6. The company's absenteeism rate and voluntary turnover rate, disaggregated by "designated groups" already identified in the CBCA;
7. A description of the company's efforts to attract and retain qualified employees, accompanies by disclosure of key indicators including the length of service for both part-time and full-time employees, and the

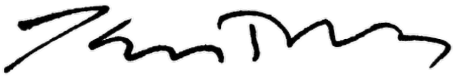
company's internal promotion rate, disaggregated by "designated groups" already identified in the CBCA;

8. A description of the Company's plans to identify and address any racial and gender pay disparities and promote a diverse and inclusive workplace;
9. Any differential in pay for "designated groups" identified by the company for the reporting period at each quartile (defined by pay levels) within the company; and
10. The ratio of total CEO compensation to the median wage of workers at the company during the reporting period.

We welcome ISED's consultation on these measures and look forward to embedding accountability measures in CBCA regulations to improve outcomes for workers, retirees and pensioners, as well as shareholders.

If you would like to discuss any of these proposals in more detail, please do not hesitate to contact me to arrange a meeting.

Regards,



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