Pension Investment
Association of Canada

Association canadienne des
gestionnaires de caisses de retraite

CORPORATE GOVERNANCE PRINCIPLES AND GUIDELINES
(Approved by the Board of Directors October 5, 2017)

Introduction

The Pension Investment Association of Canada (PIAC) is the representative association for pension funds in Canada in pension investment and related matters. The mission of PIAC is "to promote sound investment practices and good governance for the benefit of pension plan sponsors and beneficiaries”.

PIAC believes that good corporate governance is the effective oversight, direction, and control of a corporation. PIAC expects that the application of these Corporate Governance Principles and Guidelines by PIAC members to the public companies in which they invest, will assist in improving corporate governance, enhancing long-term shareholder value, and increasing confidence in capital markets.

Methods to Improve Corporate Governance

Pension funds may influence and improve corporate governance practices by voting their shares through the proxy voting process, participating in organizations advocating for effective corporate governance (such as PIAC, the Canadian Coalition for Good Governance, International Corporate Governance Network, Asian Corporate Governance Association and Council of Institutional Investors) and engaging in collaborative and direct dialogues with companies.

Shareholder Rights

Shareholder rights, which include the right to vote, to receive the remaining property of the corporation on dissolution, and any other rights provided by statute, are assets. In particular, voting rights should be exercised by fiduciaries with care, skill, prudence and diligence, and on an informed basis, for the exclusive benefit of pension plan beneficiaries to protect and enhance long-term shareholder value.

Principles and Guidelines

1. **One-Share, One-Vote Standard.** All shareholders should be treated equally. PIAC therefore endorses the "one-share, one-vote" standard. Companies should not issue shares with unequal or subordinate voting rights. Companies with dual-class share structures should implement appropriate measures to protect the rights of all shareholders, including the rights of minority shareholders, particularly in the event of a take-over bid. Dual-class share structures should be closely monitored, and their collapse should be supported when proposed by the board and in the best interest of shareholders.

2. **Share Rights and Attributes.** Companies should disclose the rights and attributes of their securities on a by class and series basis. In particular, any divergence from the 'one-share, one-vote" standard, such as share structures which allot voting power to certain shareholders disproportionate to their economic interests, should be disclosed and explained.

3. **Shareholder Approval Matters.** Boards should submit the following to shareholders for approval: amendments to the company's governing documents, company share repurchases and/or proposals that may erode or dilute the rights of existing shareholders including the dilutive issuance of shares, equity-based compensation plans or material revisions to such plans, or any other material and extraordinary transactions such as mergers and acquisitions.

4. **Anti-Takeover Mechanisms.** Shareholder rights plans ("poison pills") and other structures or transactions that act as defensive tactics or anti-takeover mechanisms should be put to shareholder vote. Only non-conflicted shareholders should be entitled to vote on such plans or transactions and the vote should be binding. Poison pills should be time limited and put periodically to shareholders for re-approval.

5. **Disclosure.** Shareholders should be given sufficient information regarding upcoming ballot proposals and ample time to review the proposals in order to make informed judgments.

6. **Bundled Proposals.** Shareholders should be given the opportunity to vote on individual proposals as opposed to voting on multiple ballot items in a linked (bundled) proposal.

7. **Voting Standards.** Supermajority provisions should only be required where prescribed by law. Simple majority should apply to votes on all other matters.

8. **Voting Result Disclosure.** Detailed voting results should be disclosed to the public as soon as possible following shareholder meetings. Where a company has a dual-class share structure, the voting results should also be disclosed to the public on a per class basis.

9. **Proxy Access.** Shareholders should have meaningful proxy access offering them the right to submit proposals, including the ability to nominate director candidates for inclusion in a company's proxy materials, subject to reasonable limitations.

10. **Advanced Notice Provisions.** Companies may adopt policies and by-laws prescribing timeframes and procedures to nominate directors for election to the board, provided that they are legitimately used to preserve shareholder interests, and that they do not unreasonably limit the ability of shareholders to nominate directors for election to the board.

11. **Shareholder Proposals.** Boards should thoughtfully consider shareholder proposals that promote long-term value creation, improve transparency or increase the accountability of the board to shareholders. Resolutions receiving a majority of shareholder support should be implemented within a reasonable timeframe, and preferably before the next annual meeting of shareholders, even when the proposal is non-binding. If the board fails to implement a majority supported shareholder resolution, disclosure of the reasons for this should be communicated to shareholders.

12. **Engagement.** Boards and management should participate in ongoing dialogue with shareholders and disclose how they are doing so.

Boards of Directors Election and Composition

The board of directors is responsible for overall stewardship of the company. The board collectively represents all shareholders, rather than particular special interest groups. Boards should have the appropriate balance of skills, experience, independence and knowledge of a company and its sector to enable them to discharge their respective duties and responsibilities effectively.

Principles and Guidelines

1. **Board Independence.** Boards should have at least a majority of independent directors. A director is independent if he or she has no direct or indirect material relationship with the company which would be reasonably expected to interfere with the director's independent judgment. Length of directorship should be taken into account, as an extended length of tenure may compromise the independence of a director. As part of scheduled meetings of the board of directors, the independent directors should hold *in camera* sessions at which non-independent directors are not present.

2. **Majority Voting.** A majority vote policy for uncontested elections of directors should be adopted. Under a majority voting policy, any director who fails to obtain more than 50% of the shareholder votes cast ‘for’ their election must tender their resignation and that resignation must be accepted by the board within 90 days, barring exceptional circumstances. The board must use its discretion in a manner consistent with its fiduciary duties and aligned with the spirit of shareholder accountability.

3. **Annual and Individual Director Elections.** Shareholders should be given the opportunity to

elect directors individually, on an annual basis, as opposed to being presented with a slate of director nominees.

4. **Board Leadership.** Chair of the board and Chief Executive Officer ("CEO") are separate roles and should be held by two different individuals. The CEO manages the company and the Chair manages the board, which oversees management. The Chair of the board should be an independent, non-executive director. If the two positions are held by the same individual, an independent director should be appointed as "lead director" to manage the board and oversee management until such time that an independent Chair can be appointed.

5. **Competency and Diversity.** Board members should have the necessary experience, skills, competency, integrity and overarching commitment to represent the long-term interests of shareholders. Directors with diverse backgrounds and experiences strengthen board performance. Boards should adopt a diversity policy and develop a system for identifying diverse candidates. Women and minority candidates should be regularly considered for open directorships. Age and tenure are also relevant factors to ensure a balanced board and to facilitate board refreshment and diversity.

6. **Education and Orientation.** All new directors should be provided with a comprehensive orientation. Continuing education opportunities should be available for all directors.

7. **Board Size.** A board must consist of an appropriate number of members to allow it to operate efficiently. There is no specified minimum or maximum number of members; instead, the size of the board will be a function of the nature and size of the company and applicable industry standards.

8. **Commitment.** In order for directors to devote the required amount of time to their board responsibilities, they must limit the number of other directorships that they accept, taking into account whether a specific director is also a public company executive. Directors should attend all board meetings, including committee meetings if applicable, and disclose reasons for absences in the proxy circular.

Boards of Directors Duties

Management is accountable to the board of directors. The board should maintain an open relationship with the CEO and work with management to promote the long-term success of the company by monitoring the implementation of the company's long-term strategy. The board should appoint the CEO, maintain a CEO succession plan, and ensure that the roles of board members and management are appropriately defined.

Shareholders should generally not interfere with decisions of management, but should ensure that the board is capable of independent thought and action, and possesses the competencies to effectively discharge its responsibilities, including oversight of management performance.

Boards should determine the risk appetite and establish the appropriate "tone at the top" to cultivate a corporate structure that gives high priority to ethical standards and integrity.

Principles and Guidelines

1. **Board Succession.** The board should, at all times, have a director succession plan in place, considering the impending expiry of board terms, and directors' intentions to stay on, so that the board may identify gaps and proactively identify and recruit potential board nominees.

2. **Director Evaluation.** The board should take a pro-active approach to evaluating itself, with the implementation of a formal and robust evaluation process which is led by the independent Chair of the board or independent lead director. The process should be intrinsically linked to the company's strategy and focus on satisfying the needs of the board, with due regard for the diversity of skills, backgrounds, experiences, and qualifications of each director.

3. **Board Committees.** Boards should have a sufficient number of board committees to ensure key board responsibilities are carried out. At a minimum, boards should form the following committees:

    - Audit Committee
    - Compensation Committee
    - Nominating/Governance Committee

    Decisions about committee membership should be made by the whole board, based on recommendations from nominating and governance committees.

    The Audit Committee should be solely comprised of independent directors, and at least one member of the Audit Committee should have the necessary accounting or financial expertise (e.g. a chartered accountant, certified practicing accountant, or retired CFO) in order to be considered financially literate. Audit Committees should ensure that auditor independence is maintained and provide appropriate disclosure in respect to payment of fees for non-audit services provided by their external auditors.

For committees other than the Audit Committee, at minimum, there should be a clear majority of independent directors, with the chair being independent.

4. **Committee Charters.** Boards and committees should have written charters, which clearly define roles and responsibilities, and include processes to regularly evaluate and improve the performance of the board, its committees and the contribution of individual board and committee members.

5. **Corporate Governance Disclosure.** Boards should report annually to shareholders on the company's governance standards and practices, and its compliance with the governance requirements of securities regulators, stock exchanges, professional authorities, and internal policies.

6. **Conflicts of Interest.** Boards should have procedures in place to ensure any conflicts of interest are appropriately dealt with, so that, for example, directors with any potential conflicts are recused from pertinent meetings or from participating in and voting on those matters, with the recusal duly recorded in the minutes, in order to ensure that the directors may exercise independent judgement.

7. **Risk Management.** Boards have a responsibility to ensure they are adopting a proactive and dynamic approach that results in effective oversight of risk management. The board and senior management should jointly determine the company's reasonable risk appetite, oversee implementation of standards for managing risk, and foster a culture of risk-aware decision-making. The board should hold management accountable for designing and implementing an effective risk management system.

8. **Director Compensation.** Directors' compensation should be in the form of directors' fees and/or shares (or restricted share units). Stock options are generally not an appropriate form of compensation for directors. Stock options do not align the interests of the directors and shareholders as clearly as shares, particularly when the options are "under water." As well, the cost of stock options to the shareholders cannot be as easily determined as directors' fees or shares.

9. **Share Ownership Guidelines.** Minimum share ownership guidelines and holding requirements should be established and disclosed annually for directors in order to align the interests of directors with those of shareholders.

10. **Director Loans.** Loans to directors to purchase shares should be prohibited. The director's interest will be better aligned with that of the investor if they use their own resources, not those of the company, to purchase shares.

11. **Extraordinary Transactions.** Where boards are considering extraordinary transactions such as mergers, acquisitions, or going-private transactions, they should follow best practice such as striking an independent committee and accessing independent financial and legal advisors.

12. **Related Party Transactions.** Related party transactions should be approved and conducted in a manner that ensures proper management of conflict of interest and protects the interest of the company and its shareholders. Members of the board and key executives should be required to disclose to the board whether they, directly, indirectly, or on behalf of third parties, have a material interest in any transaction or matter directly affecting the corporation.

Executive Compensation

Executive compensation arrangements should be fair to both management and shareholders. Companies are expected to exercise moderation and restraint in their compensation practices while maintaining the company's competitive position. The principal interest of institutional investors is to ensure long-term growth of shareholder value. Shareholders should consider whether executive pay is adequately aligned with performance, whether there is an appropriate balance between base pay and incentives, and whether the period over which performance is measured, balances shorter and longer term outcomes.

Growth in executive compensation should be tied to growth in long-term shareholder value, in compliance with risk management policies.

Principles and Guidelines

1. **Annual Advisory Votes.** Boards should adopt an annual advisory vote on executive compensation to provide shareholders with an opportunity to express their views on the board's approach to executive compensation. Boards should respond to and address shareholder concerns.

2. **Role of Compensation Committee.** An independent Compensation Committee, with the aid of independent expert advice, should be responsible for the creation, implementation, evaluation, and disclosure of the company's remuneration program. Shareholders should be informed at least annually about the Compensation Committee's structure and decision-making process along with the principles and structure of the company's executive compensation. To ensure the compensation consultant is independent, the Compensation Committee should engage the consultant and also oversee the work done. All fees paid to compensation consultants should be disclosed.

3. **Pay for Performance.** Compensation plans should be clearly linked to company performance and should include specific financial and non-financial performance targets or hurdles.

Performance should also be evaluated on a relative peer group basis. There should be a positive and significant correlation over a reasonable period between compensation and the enhancement of shareholder value. Although boards should have some flexibility in awarding compensation, use of discretion should be clearly explained.

4. **Clawback & Anti-Hedging.** Management incentive plans should include performance adjustment mechanisms such as clawback provisions or malus structures which allow the company to withhold the payment of any sum, or recover sums paid, in the event of material misstatement or restatement in the financial statements of the company or in the event of serious misconduct. Companies should also adopt anti-hedging and anti-pledging policies for directors and executive officers.

5. **Discretionary Payments.** The use of compensation awards that are outside of the regular compensation plan should be limited only to exceptional circumstances, and the board should provide a compelling rationale for the use of such awards.

6. **Stock Compensation.** Unrestricted stock options, options priced below current market value, and the re-pricing of options are not acceptable compensation practices. In addition, total dilution and the rate of option grants ("burn rate") should be limited. Change of control payments, severance, benefits and pensions should optimize shareholder value without unduly deterring initial unsolicited bids or follow-on offers.

7. **Disclosure.** Detailed disclosure regarding executive compensation, including disclosure of the total compensation and retirement benefits for the top five senior executives at a minimum, must be provided for, at least, the past three years so that compensation plans can be better understood and evaluated by shareholders. The compensation discussion and analysis ("CD&A") should be reviewed and approved by the Compensation Committee and included in proxy materials.

8. **Share Ownership Requirements.** Minimum share ownership guidelines and holding requirements should be established and disclosed annually for senior executives in order to align the interests of executives with those of shareholders.

9. **Loans to Executives.** Loans to executives to purchase stock or exercise options should be prohibited. The executives' interest will be properly aligned with that of the investor if they use their own resources, not those of the company, to purchase stock or exercise options.

Takeover Protection

Takeover protection measures should consider shareholder voice and the growth of long-term shareholder value.

Principles and Guidelines

Takeover protection measures should strengthen the capacity of the board and management to respond to takeover offers in a manner that enhances long-term shareholder value. They should strike a balance between targets and bidders, and must primarily serve the interests of all shareholders. Measures that could prevent a competitive auction, thwart a bidder or negatively affect shareholder rights should not be adopted.

Takeover protection measures should be submitted to shareholders for a vote.

Environmental, Social, and Governance (ESG) Factors

A company's ability to manage material environmental, social, and governance (ESG) factors, can impact long-term corporate profitability. Over the long-term, these ESG factors may manifest themselves into financial, operational, reputational and strategic risks or opportunities. Disclosure of a company's management of material ESG factors is therefore of critical importance to investors. PIAC expects companies to adopt policies to address material ESG risks to their business, such as codes of conduct and policies addressing corruption, bribery, human rights and supply change management, where appropriate. Furthermore, the board of directors should ensure processes and procedures are in place to enable them to exercise effective oversight of key ESG risks.

Principles and Guidelines

1. **Adherence to Standards.** Companies should, wherever possible, uphold and adhere to principles established in international agreements, especially those which are upheld by the country/countries in which they are incorporated and/or the country/countries in which they operate.

2. **ESG Disclosure.** Companies should provide reasonable and timely disclosure to shareholders and potential investors of material ESG factors and risks, such as climate risk, carbon emissions, health and safety, human rights and corruption. The board of directors should oversee and approve these disclosures.

3. **ESG Integration.** The board of directors should ensure that there is a process in place to identify, assess and manage material ESG risks to a company's business, and that these factors are integrated into strategic and operational planning.