Pension Investment Association of Canada

Association canadienne des gestionnaires de caisses de retraite

CORPORATE GOVERNANCE PRINCIPLES AND GUIDELINES
(Approved by the Board of Directors on September 29, 2014)

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, thereby enhancing long-term shareholder value and increasing confidence in capital markets. When combined with an objective self-assessment process, good governance in Canadian companies can enhance the competitiveness of the Canadian economy.

Methods to Improve Corporate Governance

The vehicles used by pension plans to improve corporate governance practices include voting their shares through the proxy voting process, participation in organizations that champion the implementation of effective corporate governance (such as PIAC, the Canadian Coalition for Good Governance, and International Corporate Governance Network) and collaborative and direct engagement with companies. The principal avenue for investors to advocate and enhance corporate governance is by exercising their voting rights. Institutional investors, and pension plans in particular, have a fundamental fiduciary duty to their beneficiaries to exercise shareholder voice by voting their proxies, as the proxy is viewed as an extension of property that is held on behalf of the beneficiaries of the plan.

Shareholder Rights

Shareholder rights, which include the right to vote, the right to receive the remaining property of the corporation on dissolution, and any other rights provided by statute, are assets. These rights must be managed with the same care, skill, prudence and diligence as any other asset. Such rights must be exercised by fiduciaries for the exclusive benefit of pension plan beneficiaries in such a way as to protect and enhance long-term shareholder value.

Principles and Guidelines

1. All shareholders should be treated equally. 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 kept under review, and potentially collapsed if considered conducive as determined by the board and by shareholder vote.

2. The board should disclose the attributes of company shares, according to share classes and series of shares to shareholders on a timely basis. Any divergence from a 'one-share, one-vote' standard, such as dual class share structures which allot certain shareholders voting power disproportionate to their economic interests, should be disclosed and explained.

3. 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. Shareholder rights plans ('poison pills') or other structures that act as anti-takeover mechanisms should also be put to shareholder vote. Only non-conflicted shareholders should be entitled to vote on such plans and the vote should be binding. Plans should be time limited and put periodically to shareholders for re-approval.

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

6. 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. Supermajority provisions should only be required where prescribed by law. Simple majority should apply to votes on all other issues.

8. Detailed voting results should be disclosed to the public as soon as possible following shareholder meetings.

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

10. Boards should act upon resolutions receiving high levels of shareholder support or explain their lack of compliance within a reasonable length of time, regardless of whether the proposals are binding or non-binding.

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

Boards of Directors

The board of directors is responsible for overall stewardship of the company. The board collectively represents all shareholders, rather than particular special interest groups. Management is accountable to the board of directors. The board should reinforce these concepts in making its

management appointments and by appropriately defining the separate roles of board members and management.

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

Principles and Guidelines

1. Boards should have 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. A majority vote policy for the election 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. 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. 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.

5. Chair of the board and Chief Executive Officer are separate roles and should be held by two different individuals. The Chief Executive Officer manages the company and the Chair manages the board, which oversees management. 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.

6. Board members should have the necessary experience, skills, diversity and overarching commitment to represent the long-term interests of shareholders. The board should provide all new directors a comprehensive orientation and continuing education opportunities for all directors. Board terms should include reference to appropriate tenure for directors in order to facilitate board refreshment and diversity.

7. 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. 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. Directors should attend all board meetings, including committee meetings if applicable, and disclose reasons for absences in the proxy circular.

9. Boards should have a sufficient number of board committees to ensure key board responsibilities are carried out. The following committees should include only independent directors or at minimum a clear majority of independent directors:

- Audit Committee
- Compensation Committee
- Nominating/Governance Committee

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

11. 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.

12. 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, with the recusement duly recorded in the minutes, in order to ensure that the directors may corporately exercise independent judgement.

13. Boards have a responsibility to ensure they are adopting a proactive and dynamic approach that results in effective oversight of risk management. The board should hold management accountable for designing and implementing an effective risk management system.

14. 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 with those of the shareholders as clearly as shares do, 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.

15. 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.

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

Executive Compensation

Executive compensation arrangements should be fair to 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.

Principles and Guidelines

1. 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. 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 oversee the work done as well. All fees paid to compensation consultants should be disclosed.

3. Compensation plans should be clearly linked to company performance and should include specific 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. 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.

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

5. 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.

6. 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.

7. 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 to purchase stock or exercise options, not the company's resources.

8. The compensation discussion and analysis ("CD&A") should be reviewed and approved by the compensation committee and included with the proxy material.

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 a 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 the long term 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, with certain industries impacted more than others. Over the long term, these ESG factors may manifest into financial, operational, reputational and strategic risks, and opportunities. Disclosure of a company's management of material ESG factors is therefore of importance to investors. PIAC expects companies to adopt codes of conduct for their employees.

Principles and Guidelines

1. Companies should, wherever possible, uphold and adhere to principles established in international agreements, especially for those which are upheld by the country of their incorporation and/or countr(ies) of their operations.

2. Companies should provide reasonable and timely disclosure of material ESG factors and risks to shareholders and to potential investors.